H.R. 1842, THE CREDIT AND CHARGE CARD DISCLOSURE AND INTEREST RATE AMENDMENTS ACT OF 1993; AND H.R. 2175, THE CREDIT CARD REFORM ACT OF 1993

HEARING

BEFORE THE

SUBCOMMITTEE ON
CONSUMER CREDIT AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

FEBRUARY 10, 1994

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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H.R. 1842, THE CREDIT AND CHARGE CARD DISCLOSURE AND INTEREST RATE AMENDMENTS ACT OF 1993; AND H.R. 2175, THE CREDIT CARD REFORM ACT OF 1993

THURSDAY, FEBRUARY 10, 1994

House of Representatives,
Subcommittee on Consumer Credit and Insurance,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:07 a.m., in room 2128, Rayburn House Office Building, Hon. Joseph P. Kennedy [chairman of the subcommittee] presiding.

Present: Chairman Kennedy, Representatives Watt, McCandless, Castle, and King.

Chairman Kennedy. The subcommittee will please come to order.

This morning the subcommittee considers two bills that focus our attention on the credit and charge card industry. They are authored by two of Congress' most distinguished Members, Chuck Schumer and Jim Moran.

Both of these Members have been solid friends to consumers over the years. Mr. Schumer is the leader on the Banking Committee in efforts to protect the ordinary citizens of this country; and Congressman Moran, although no longer on this subcommittee, continues to speak on behalf of people whose voices are too little to be heard in the Halls of the Congress of the United States.

We worked hard on a number of issues together when Jim Moran was on this Committee. I remember fondly—and I certainly wish we had had him on this Committee yesterday.

Both of these Members have brought to our attention several practices in the credit card industry that deserve the subcommittee's scrutiny.

For example, credit card interest rates continue to be troublingly high. Across the country, the average is about 16.5 percent and sometimes as high as 20 or 24 percent. These rates are lower in absolute terms than a few years ago when the average rates hit 19.5 percent.

However, the spread between credit card rates and standard rates, like the rate for 30-year Treasuries, is actually higher than it was in the roaring 1980's. So credit card consumers, for reasons that are not clear, haven't reaped the benefits of the current low interest rate climate.

Second, it appears that consumers are being hurt by unexpected changes in credit card rates. Cardholders are finding that their rates are going up, even though they have been promised fixed rates.

What is worse, higher rates are being applied to outstanding balances, meaning money that they have already borrowed. It is hard to see the fairness of this practice. Cardholders are falling unknowingly into deeper debt because of misleading information printed on their statement.

Right now, 72 percent of all cardholders owe an outstanding balance at the end of each month and they know that they can keep their account current by making a minimum payment, as little as 1 percent or less, of the total amount owed. What they don't know is that it could take them years to pay off their obligation at sky-high rates.

An $1,100 balance on a Chase Bankcard with a 19.8 percent rate will take 15 years to pay off, paying only the minimum monthly amount. Total interest on the $1,100 debt would exceed $1,800, over 1½ times the principal. The question we have to ask is whether or not consumers would go this route if they knew how long and how much it would take to pay it off.

Credit card companies are reluctant, if not downright hostile, to allowing consumers to pay State and local debts by credit cards. Apparently, they don't like the fact that the governments want the option of charging a fee to consumers who decide to pay by credit card because it might make the method of payment less attractive than others.

This is certainly an issue that deserves to be explored. We don't want to lose an opportunity to allow a method of payment that is more convenient for both consumers and governments without in any way cutting into the return of the credit card companies.

Both Congressman Schumer and Congressman Moran have crafted thoughtful legislation designed to respond to these practices in the marketplace. Mr. Schumer's bill, H.R. 1842, would provide added disclosure of interest rates in the hope that it might generate some competition and drive those rates down. He would try to help consumers avoid the sting of sudden rate hikes by allowing them to pay off credit card debt at the original terms and his bill would make sure consumers know how many months and how much interest it would take to pay off a card debt at minimum levels.

Mr. Moran's bill, H.R. 2175, is very much in the spirit of the Schumer bill. It allows consumers to pay their government obligations by credit card and allows governments to charge them the cost of that service.

The subcommittee is fortunate to have both Mr. Schumer and Mr. Moran with us this morning as well as other witnesses who are well qualified to discuss their bills. I look forward to hearing their views on what we can do to ensure that consumers get the information and the options they need to make informed choices.

With that, let me turn to Mr. McCandless to make an opening statement.

Mr. McCandless. Thank you, Mr. Chairman.

In the interest of time, of both our panels and our colleagues, I will defer an opening statement. Let's get on with the hearing.

Chairman KENNEDY. Mr. King.

Mr. KING. No, sir. I have no statement. I just always wait in awe for what Mr. Schumer is going to say. He is one of my mentors in New York.

Chairman KENNEDY. Can you convince him to vote right, Chuck? Have you ever voted the same way on an issue?

Mr. SCHUMER. On Irish issues, we vote the same.

Chairman KENNEDY. But who is leading who?

In any event, Mr. Schumer, why don't you proceed.

STATEMENT OF HON. CHARLES E. SCHUMER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. SCHUMER. Thank you, Mr. Chairman.

I want to thank you for holding this hearing on what I think everyone can agree is a very important issue: Credit cards. Your leadership in consumer issues long before you attained the chairmanship of this subcommittee is renowned. And you are doing a great job on this subcommittee, I think. All of us who have been active in the consumer area thank you for your leadership.

Let me begin, Mr. Chairman, by posing a simple question: Why doesn't the credit card industry like my bill? All my bill does is require the credit card industry to keep their cardholders informed. Under my bill, credit card companies would: One, provide a monthly disclosure that lets consumers know what they are paying on their card in principal and interest charges and a yearly statement that tells them what their card costs to use in interest and fees; two, it makes clear in advertisements what their rates and fees are; three, it tells consumers when they will be raising the card's interest rate and lets the consumer cancel the card and pay off the balance at the old rate if they don't like the new deal, and tells the cardholder if they will be selling information about them to direct marketers and gives consumers the chance to opt out of these programs.

Well, maybe the reason they don't like my bill is because with real disclosure, consumers would know that they are being taken for a ride. Consumers would know that their credit card costs them more to use than just about any other source of financing, aside from loan sharks.

I know the credit card industry of today is more competitive an industry than it was even 2 or 3 years ago, and I think that is at least in part due to the kinds of pushing that many of us have done in terms of legislation, in terms of just public knowledge and information.

There are deals now that abound. Some cards have lower fees, lower rates, no annual fees. Affinity cards let you earn frequent flyer miles, and I know that interest rates have come down some, especially in the last year or two, but the average rate on credit cards, Mr. Chairman, is still an incredible 16.5 percent. The prime rate is 6 percent.

The difference between the prime rate and the interest rate you pay on credit cards has actually increased over the last 10 years. In other words, the bank's cost of money and the amount they

charge you, the consumer, is greater today than it was even when the rates were up in the twenties.

Now, is that the benefit we have reaped from a more competitive industry? No way. To illustrate my point about how high rates are in relative and absolute terms, I have taken a page from Ross Perot and brought a chart along. It costs too much to make a big chart, Mr. Chairman, so we have a little one that my staff went to Kinko's last night to put together and they were up until 11 o'clock and they deserve everyone's appreciation. Doesn't look like much for staying up to 11 o'clock.

Chairman KENNEDY. Do you have some binoculars we could use?

Mr. SCHUMER. They must have stopped in at one of the local pubs before they got to Kinko's. They really worked hard on this. Randolph didn't do that. They are not here. They are still at Kinko's.

Anyway, I have tracked the prime interest rate, the average home mortgage rate, and the fixed industry average for credit cards over the last 10 years. The prime rate dropped, as you can see, from 12 percent to 6 percent right now in 1994.

Home mortgages were quite responsive. They dropped from 12.38 percent to 6.97 percent as of Saturday, February 5. But what about credit cards? Well, they dropped, too, but not nearly as much and not nearly as fast. They went from 18.75 percent in 1984 to 16.5 percent today; a whopping drop of 2¾ percentage points.

The question is, why? Surveys have found that most consumers are flying blind. Many don't know the interest rate their credit cards charge. So one leading commentator wrote an article in the *American Banker* saying that the reason we don't need this bill is that consumers are stupid. I thought that was very persuasive.

In any case, they are not stupid. There is no way for them to know how much the interest and fees are adding up to month after month after month. If there was, consumers would more likely shop around for a better deal and there are better deals out there. That is probably why the credit card companies don't want us to know what they are charging.

My bill would provide that information, and the little companies, without advertising muscle who charge considerably less, would gain an advantage.

Now, last Friday, we saw short-term interest rates inch up a quarter of a percent, the first rise in 5 years. Both Alan Greenspan and Laura Tyson predict rising interest rates this year. That means that we will see interest rates on variable credit cards going up.

Something tells me that interest rates on the credit cards will be more responsive to increases in the prime rate than they have been to the decreases. And if that occurs, the consumers must be notified in advance and have a chance to able to drop the cards if they don't like the new deal that the bank offers.

Mr. Chairman, you will probably hear from the industry representatives who follow me here today about how the disclosures in my bill would cause credit card interest rates to go up. They don't talk about advertising. When they advertise on TV or everything, that causes credit card interest rates to go up, but that is a public service to get people to buy their card. But when they ad-

vertise actually what the rates are and what the real product is, oh, no we can't do that.

I make a deal with every credit card company. Don't spend any money on advertising and don't do this bill.

But the advertising, of course, doesn't highlight the rates and under my bill at least they would have to mention it and I am sure you saw the commentary in today's *American Banker* that was trying to make this point ad nauseam showing how healthy the credit card industry is. That study is a PR campaign and who paid for that? The industry?

It has as much credibility as tobacco industry studies proclaiming the healing powers of cigarettes.

The credit card business is a multibillion dollar industry and it spends millions of dollars in advertising to entice consumers to carry their cards. A few simple disclosures are not going to drive rates up. That is just not plausible. I think that what the credit card industry is afraid of is that the disclosure in my bill would actually drive rates down.

Mr. Chairman, I want to thank you for holding these hearings. I know that you share many of these concerns. Once again your leadership in this area is to be commended. It will go a long way in leveling the playing field for consumers and I look forward to working with you in the future on this important issue.

Here is the chart on a regular piece of paper. It looks good.

[The prepared statement of Mr. Schumer can be found in the appendix.]

Chairman KENNEDY. We will enter that chart into the record and we will keep that one for some other time.

Let me just say, Chuck, how much the subcommittee appreciates not only this particular piece of legislation, but all the work that you do on the Committee. Since long before I served on the Banking Committee, you have always been a leader on consumer issues. I know this is an issue that you have worked hard to gain the support of many of the consumer groups around the country. I think it is important and good legislation.

I would like to work with you on trying to develop a strategy so that we could actually see it become part of our Nation's laws.

As you know, we see, particularly I think in this subcommittee, all too often the power of the industry. I think that given your direct comments on how interested they already are in the legislation you filed, I am sure it will be an uphill fight. However, I think that these kinds of events this morning go a long way toward improving the likelihood that we can get it passed.

So we again thank you for taking up the cause of the consumer in what is obviously legislation that is needed. These interest rates that are being charged and the lack of rate reductions that has taken place in the credit card industry is astounding; we thank you for your legislation.

Our next witness is Representative Jim Moran of Virginia. Mr. Moran is a renowned member of the Appropriations Committee and he is also the sponsor of H.R. 2175, which would permit Federal, State, and local governments to accept payments by credit cards and allow the government to pass the cost of credit card transactions directly on to card paying customers.

Mr. Moran is particularly qualified to talk about this issue because of his background as an elected official at the local level. He was kind enough to bring in several officials from his district that have been tremendously innovative in using credit cards and finding a remarkable response by consumers as being a choice that they would like to have. But these rate differentials have posed a real problem for the cities and towns as well as the credit card companies and we look forward to learning from you how you think we ought to solve the problem.

Thank you, Mr. Moran. Please proceed.

STATEMENT OF HON. JAMES P. MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. MORAN. Thank you, Mr. Chairman.

I think we found some officials who were particularly astute and happened to live in your district as well that shared this perspective.

Chairman KENNEDY. Kind of like you, huh?

Mr. MORAN. Yes.

I appreciate you giving us the opportunity to testify before this subcommittee, and I also thank Mr. McCandless and Mr. Castle and Mr. King. It is a pleasure to have you on the panel.

I have just a small commonsense little provision, Mr. Chairman. There are really no good guys or bad guys. Certainly, the government finance officers are some of the finest civil servants in the country. They do wonderful work and get very little credit. They are usually the ones that get the brunt of the taxpayers' anger because they have to collect the taxes that we politicians levy. And since the bank card holders represent tens of thousands of Americans, they are wonderful Americans.

And VISA and MasterCard and the banks are nice people as well. And in fact, as you know, and Mr. Schumer knows, that was one of the reasons why the banking system was able to survive over the last several years that profit center because they certainly weren't getting it out of real estate or small business loans.

But this bill really shouldn't—we really shouldn't have to go through this process of getting something like this enacted.

It doesn't make sense that taxpayers shouldn't be able to pay their taxes by use of a credit card. Obviously, there is a convenience factor. They don't have to wait in long lines to pay their taxes. If you are handicapped, it is far more than a convenience factor. It is very important that you be able to use the phone and pay your taxes using your credit card. But even more than that, there is a financial aspect to this.

If you can use your credit card, you don't get the stigma of being late on your taxes. You don't have to pay a 10 percent penalty plus the interest that local and State governments have to charge.

So it only makes sense that people who choose to use their credit card ought to be able to use their credit card to pay taxes. Now, why can't they? It really begs the question. Well, the problem is that there are two sources of profit that credit cards and the banks who issue credit cards get.

And one of them, obviously, is the interest that Mr. Schumer enlightened us about with this chart. And I am sorry I don't have

such fancy charts to share with you. And oftentimes this interest is five, six times what the rate of inflation is. So that is a substantial profit center. But beyond that, credit card companies charge a 2 or 3 percent surcharge for the use of a credit card.

Now, they don't want you to know that. And I didn't even know it before I introduced this bill. I didn't realize it because I don't pay that extra surcharge unless it is at a service station. But retail firms who use credit cards are forced to take that surcharge and spread it over the cost charged to everyone so that people who pay by check and cash pay for that 2 percent surcharge just as the person who gets the convenience of using a credit card.

Now, that makes sense from the retail standpoint because they figure that people with credit cards are going to spend more than they can afford, buy more things because of the ease of the credit card. They don't see the cash coming directly out of their pocket and they can make time payments.

It doesn't make sense from the government's standpoint, because the finance officers can't increase other people's taxes to pay for the surcharge that is incurred by people who want the convenience of a credit card. They can't increase other people's tax rates to make up for that like retail stores do. So that is the problem.

Now, when some of the local jurisdictions that are represented here tried to offer credit cards as a way of paying their taxes, the banks they have a relationship with were fined or threatened that they would fine them as much as $100,000 if they didn't hide this credit card surcharge. So, obviously, they had to pull back and not offer this convenience to their customers.

All my bill says is that if local and State governments want to, they ought to be able to charge the fee to the people who incur the fee because they want the convenience of using a credit card. That is all it does. It only makes sense.

Now, Vice President Gore's National Performance Review recommended that people be able to pay their Federal income taxes by the use of a credit card. But they have the same problem. Is it fair to raise the Federal income tax rate on everyone in order to hide that 2 or 3 percent surcharge that is really only incurred by the people who use the convenience of the credit card?

It ought to be a personal choice. Just like mail order. If you want the convenience of getting something from mail order catalog, you pay the shipping charge. This is the same thing. If you want the convenience of using a credit card, you ought to pay the fee that is incurred. That is all it does.

Now, the bankholders I understand oppose this because they don't believe there ought to be any surcharge, but that is unrealistic. All that means is that if they maintain that position, no one will be able to use a credit card to pay their income or property tax or any other government fees.

I think that it is a commonsense bill, and I think it is a long time coming. We are getting into a technological era where we can make it so much more convenient to pay your taxes.

We ought to be able to give the American taxpayer at every level of government the opportunity to avoid going down to the tax collection department in person. They ought to be able to call up, give their credit card number, and make the payment. If there is an

extra 2 percent to use a credit card, the person can decide. And then it is time payment. But they don't get the stigma. They don't have to pay the penalty.

It only makes sense, Mr. Chairman. And while the credit card companies and banks may have some different perspective and point of view on this, I would hope that this subcommittee would recognize the rationality of it and approve this small commonsense provision.

[The prepared statement of Mr. Moran can be found in the appendix.]

Chairman KENNEDY. I appreciate both of your testimonies. I think both of you have very good bills.

I would like to just ask one brief question to each of you.

Chuck, you remember a few years ago we looked at some other credit card legislation on this subcommittee and many people blamed a significant drop in the stock market, I think completely erroneously, on that legislation. One of the arguments that the banks make, of course, is that they incur very large losses on credit cards and so, therefore, that explains why those credit card interest rates are much higher.

What is your sense of the truth in that?

Mr. SCHUMER. Two things, Joe. The bill that caused the stock market to drop was a bill with a cap. And, so—and I agree with you, I don't think the two were related, but somehow or other it was tied in. But this bill is quite different than that. The leading advocate of a cap in the Congress used to be our Chairman Annunzio. He is not here. And I don't know if caps are out there at all.

Some of them incur losses. The ones who tend to incur losses are the cnes that are marketing their credit cards all over the place.

The stories that are well known of dogs and little kids being sent credit cards in the mail, and so forth. If they are facing losses, we are not saying that they can't charge the interest rate they want to charge. Let the public know to foster competition. Right now it is difficult for people to know because while there is the so-called Schumer box from the previous piece of legislation that we passed, that is only on the application.

That is nowhere else. And if you look, just look as I have, at the advertising and the information they send you, they don't make a big deal about telling you it is 16.75 percent or whatever the rate is. It so happens the companies, ironically, that tend to charge the lower rates are those that are the smaller ones trying to get market share and they don't have the kind of money to pay for advertising and all of that.

I have talked to some of the people who issue those credit cards. So if some incur losses, they will charge a higher interest rate because they are more free. It is the capitalist system, they are more free in giving them out.

All we are saying is let the people know what the rate is. It is pure Adam Smith, capitalist, free enterprise thinking that is behind this bill.

Chairman KENNEDY. Are there any other terms and conditions that a credit card might offer that would make it a more viable card from a consumer perspective that is outside of the rate?

Mr. SCHUMER. You bet. And we propose disclosure of all of it, the annual fee, grace periods, some have longer or shorter grace periods. All we are saying is allow the consumer to be aware of this by making it clear. Because obviously, it sticks.

You know, they used to say, oh, they gave reasons for why the interest rates were the same. Why were—why the interest rates were high. Why were they all exactly at 19.8 percent?

When you generally have an oligopolistic market where you have a few big companies controlling, no one wants to create a rate war, because they all have to come down and their profits are lower. The only person who benefits is the consumer.

But I would argue that our job is not to see an unprofitable credit card industry, but it is to see one that meets the dictates of the free market and lets the consumer make his or her choice.

Chairman KENNEDY. Thank you very much, Mr. Schumer.

Mr. Moran, I understand the points that you are making with regard to providing the consumer with this additional form of payment. My understanding is that there are some localities, such as in California and New Jersey, that actually allow some limited use of credit cards without charging the fee.

Now, can you just tell us why perhaps this should not be something that would be negotiated as it is between a restaurant and a credit card company? Why would it not be something that should be negotiated by the town manager or the tax collector who is in charge? Maybe it is a city treasurer who has large deposits coming in and the local bank that is responsible for some of those charges.

Shouldn't there be some way to work this out without sending the consumer the bill?

Mr. MORAN. No, if there was, I wouldn't have offered the bill, Mr. Chairman. In the first place with restaurants, the retail establishments, with the exception of the exemption for service stations, there was a provision that Senator Proxmire put in many years ago that enabled credit card companies to hide this surcharge.

Now retail establishments have the option. They can either not use credit cards at all, which would pretty much put them out of business in today's economy and society, or they can spread that surcharge over everyone's cost.

As I said, that dynamic didn't apply to government because you can't increase everybody else's taxes and you have to pay the taxes and it is a defined amount that you pay. It is not a question of supply and demand purchasing power.

Now you have some situations where some localities, for example, have been able to define a credit card—find a credit card that will offer the ability to use a credit card, but it tends to be the smaller ones.

VISA and MasterCard are the big gorillas in this scene and they are the ones that people normally use. They are the ones that if we are going to offer the ability to use a credit card, it really needs to apply to VISA and MasterCard. And VISA and MasterCard in the government finances will tell you, have threatened banks with fines of up to $100,000 if that bank allows the local government to use their credit card in a way that would pass the fee on to the people using the card themselves.

They have the ability to force compliance. Local governments really have very little option. All this bill says is give the local governments the option. They don't have to do this. They can do it any way they want, but it would give them the ability to charge that fee specific to the people who are getting the benefit of the convenience.

Now, I think, that there may be an improvement to the bill that you may want to add in, but that is up to you. You might want to have a fully balanced bill. You might want to say, well, if governments charge that fee, specific to the person that wants the convenience, then they ought to limit it to the actual fee. And they shouldn't increase the fee to get any additional revenue for the government themselves.

In other words, it should be limited to the actual amount of the surcharge. You may want to write that into the bill. I think that may improve the bill. And that would be a more balanced approach perhaps to the issue. But the answer to your question is no, that approach to leave the system as it is just isn't working.

Chairman KENNEDY. Can you eliminate a tax on credit card use? Anyway, Mr. McCandless.

Mr. MCCANDLESS. No, Mr. Chairman. I will save my questions for those coming later.

Thank you.

Chairman KENNEDY. Mr. Castle.

Mr. CASTLE. I have no questions.

Chairman KENNEDY. Mr. King.

Mr. KING. No questions.

Chairman KENNEDY. We thank you both for your excellent testimony and look forward to working with you to get this legislation moving.

Mr. MORAN. Thank you, Mr. Chairman and members of the subcommittee. Thank you.

Mr. SCHUMER. Thank you.

Chairman KENNEDY. There being no further questions, I would like to thank our first two witnesses and I would like to ask our next panel of witnesses to please come forward and be seated at the table.

We thank you for coming this morning and your entire written statements will be submitted for the record so I ask you to try to limit your oral statements to 5 minutes so that we can get to the questions, which generally get to the heart of the matter quickly. So if you would try to limit your oral statements to 5 minutes and understand that your full written statements will be added into the record, we would appreciate it.

I would like to introduce our first witness, and I have asked Congressman Mike Castle to take care of the first order of business.

Mr. CASTLE. I am not sure what the order of the witnesses is, but I wanted to introduce Dick Vague because he is a constituent in the State of Delaware. He is a transplanted Texan and saw the wisdom of coming to Delaware where he is the president of First USA in Delaware, a large credit card operation there.

He is testifying today on behalf of MasterCard. We happen to have our offices in the same building in Wilmington as it turns out; my congressional office is there. And he has proven to be a tremen-

dously able person in our community and one who has drawn a lot of respect in a lot of ways.

Dick, we are delighted to have you here today.

Let me apologize, Dick. I am going to have to leave to go to a joint hearing in the Senate, but I will try to last through as much of this testimony as I can.

Chairman KENNEDY. Mr. Vague, please proceed.

STATEMENT OF RICHARD VAGUE, PRESIDENT, FIRST USA BANK, ON BEHALF OF MASTERCARD AND VISA

Mr. VAGUE. Thank you.

Thank you for the opportunity to testify. My name is Richard Vague. I am president of First USA Bank in Wilmington, Delaware. I am appearing today on behalf of both MasterCard and VISA. We have also submitted written testimony for the hearing record.

We appreciate the opportunity to testify before the subcommittee to discuss the intense competition in the credit card industry. We also appreciate the opportunity to present our views on H.R. 1842.

The credit card industry is one of the most competitive in the United States. There are nearly 6,000 banks and other financial institutions in this country competing aggressively for customers and offering tens of thousands of different credit card programs. And there are special credit card banks, like our bank, entering this market frequently.

This highly competitive environment has produced a vast range of reduced interest rate accounts for consumers, but the consumer benefits are not measured by reduced rates alone. Credit card issuers across the country offer other diverse features, including accounts with no annual fees, programs with cash and other rebates, and such enhancements as long distance telephone discounts and frequent flyer mileage.

This product diversity means accounts specially designed for almost every conceivable consumer market segment.

In short, as the Federal Reserve Board and many economic studies have reconfirmed again and again, competition in the credit card market remains intense. This intense competition among card issuers takes place in an environment which is already regulated nearly to the point of economic chaos.

Card issuers already must comply with an exhaustive list of disclosure and other requirements under existing Federal and State laws. For example:

Card issuers already must provide extensive application and initial disclosures before a consumer can even use a credit card.

Cardholders already must receive billing statements every month detailing all account activity and current account terms.

Card issuers already must notify consumers before account terms can be adversely changed.

These disclosures already meet or exceed any possible consumer need for credit card account information. This legislation would merely increase the difficulty and cost of delivering this information to consumers by regulating every conceivable aspect of the disclosure process, including design, content, wording, type size, timing, frequency, and format.

The greatly increased costs of this regulatory micromanagement would be reflected in higher consumer credit prices and reduced credit availability, particularly for lower and moderate-income families. This is one case where more clearly is not better.

A close look at H.R. 1842 shows that it would create costly operational problems with no corresponding consumer benefits. For example, the bill would require card issuers to print detailed disclosures on the outside of envelopes, when those disclosures already must be provided inside the very same envelopes.

Another section of the bill would require the same information, in the very same tabular format, to be disclosed three separate times in the same mailing. This sort of regulatory overkill does no one any good.

Because the existing Truth in Lending Act already requires advance notice of changes in account terms, even the bill's change in terms provisions are unnecessary. The bill would require confusing procedures for cardholders to terminate their accounts and repay under existing terms.

Many card issuers already have established procedures permitting cardholders to pay off accounts on existing terms, either voluntarily or as a result of State law. But these procedures have been tailored to work on existing billing systems.

The bill would require card issuers to make costly systems changes simply to accommodate the special new requirements of H.R. 1842, with no improvement in consumer protection.

The legislation would also establish extensive new requirements for all credit card advertising, with no real benefit for consumers. Instead, H.R. 1842 would actually hurt consumers and discourage competition by effectively eliminating radio and television ads for credit cards.

The operational and economic costs of H.R. 1842 would be greatly compounded if card issuers are required to comply with differing disclosure and change in terms requirements under State law. So if Congress decides to consider any additional Federal requirements, and we hope that you do not, it is essential that the legislation preempt completely all similar State laws.

However well intentioned it may be, H.R. 1842 is the epitome of legislation that imposes operational and economic burdens that far outweigh any conceivable benefits that could be gained by its enactment. It simply is not possible to justify new regulatory burdens given the extensive competition and comprehensive regulation that already exists in the credit card industry.

That concludes my testimony. I would be pleased to answer any questions that the subcommittee may have.

[The prepared statement of Mr. Vague can be found in the appendix.]

Chairman KENNEDY. Thank you, Mr. Vague, for that clear statement.

I next want to introduce Gerri Detweiler, who is the director of the BankCard Holders of America. It is a national consumer credit educational organization with 75,000 members.

Ms. Detweiler has been a staunch advocate of consumer issues and produced several articles addressing consumer concerns. We thank you for being with us and we look forward to your testimony.

STATEMENT OF GERRI DETWEILER, EXECUTIVE DIRECTOR, BANKCARD HOLDERS OF AMERICA

Ms. DETWEILER. Thank you for the opportunity to appear before you today on behalf of BankCard Holders of America and also Consumer Federation of America and U.S. Public Interest Research Groups, we are representing more than 50 million consumers today.

I would first like to address H.R. 2175, the Credit Card Reform Act. This is not the first time that BankCard Holders of America has addressed Congress on the issue of surcharges. In 1984, we were part of a large coalition of industry groups, consumer groups, State consumer protection agencies, and others who were trying to persuade Congress to extend the ban it enacted in 1976 on surcharges.

Now, that bill appropriately addressed businesses charging surcharges, because at that time I don't believe there were any government agencies that even contemplated accepting credit cards. We have been and still are opposed to surcharges in general for the reasons I have outlined in my testimony.

I won't go over those now to save time, but I would like to address the reasons we are opposed to H.R. 2175 as it is currently written.

The three main reasons are; first of all, it does not protect consumers against usurious surcharges. The bill as it is written would allow government agencies to charge any type of surcharge. We are afraid that would lead to potential abuses by government agencies that decide to cash in on people who decide to pay by credit card.

As an example, the Virginia DMV was charging a 3.5 percent surcharge. That is much higher than the average surcharge on VISAs and MasterCards at 1.9 percent and quite higher than the 1 percent that is the best discount rate enjoyed by certain merchants.

In addition, when Virginia's DMV was charging the 3.5 percent surcharge, they were only paying 2 percent to their bank according to industry sources so the additional 1.5 percent was being used in other ways.

We are not worried about surcharges so much for the consumer who wants the convenience of using credit cards. We are worried about the consumer who is living paycheck to paycheck and can't pay her taxes and has to put them on a credit card. That consumer will be hurt most by this type of legislation because first she pays the surcharge and then she also has to pay the interest on her credit card and as we have heard from Congressman Schumer, that interest rate is typically quite high.

We think it is ironic that Congress 20 years ago decided to protect consumers against surcharges, but now is considering preventing the credit card companies from protecting the consumers against surcharges.

Next, I would address H.R. 1842, the Credit Card and Charge Card Disclosure and Interest Rate Amendment Act. I want to allow time to comment on a couple of specific proposals, so I won't get into a long debate about interest rates. But I know that you are going to hear from the industry that they are very competitive, that interest rates have come down, that people have a lot of

choices in credit cards, and that their costs are very expensive which cuts into the profit margin.

The fact is that credit cards still remain the most profitable area of consumer lending. As one industry article recently put it, they are the star of lending.

In addition, although interest rates have been coming down on credit cards, credit card companies have been recouping a lot of that lost revenue through other charges. In other words, consumers may be paying less on the front end, but they are paying more on the back end through lots of fees, the grace period, and penalty costs.

As an example, Citibank is dropping the annual fee on 7.1 million accounts. It is estimated that they are going to lose $160 million in revenue. They are going to recoup part of that revenue in part by raising late and over-the-limit fees for an additional $64 million in revenue and $20 million more in revenue through lowering the minimum payment.

Congressman Schumer's bill provides important protections against what we believe are unfair practices and one of the most important provisions in our opinion is protecting customers against arbitrary changes in the interest rate.

I have an example here of a solicitation I received which touts a 6.9 percent fixed rate on the envelope. If you open it up, you will see "fixed rate" all over the solicitation. Now, if you went to 100 consumers on the street and asked them what do you think this fixed rate means, most of them would tell you that is what the rate is going to be until I pay it off. That is what consumers think because that is the way it works for other consumer loans. But that is wrong in the credit card industry.

In the credit card industry, a fixed rate means fixed until the lender changes its mind and when the lender does change its mind, it can apply the new higher rate to your outstanding balance, money that you have already borrowed under the contract, as well as any new purchases.

The consumer has no choice. She has to go out and find another loan and hopefully qualify for it at that time and transfer the balance over if she wants to keep the low rate. The industry is going to tell you it is too expensive to do this, but I don't believe that for two reasons.

Number one, many credit card companies are located in Delaware. Delaware is sort of a haven for credit card companies and a lot of banks have moved their credit card operations there.

One of the reasons that Delaware is so attractive is that State laws very often favor the credit card industry. But Delaware is one of the few States in the country that has a law that is very similar to what Mr. Schumer is proposing already.

I simply can't believe that if this law were terribly burdensome to the industry, they wouldn't be in the Delaware State Legislature getting the legislature to change that law. They are complying already.

In addition, many issuers have a number of programs in place already. They offer different rates on different accounts, different minimum payments, different interest rates for cash advances.

This is just another simple programming change that is not going to cost them that much, but it is going to be fair to the consumer.

The consumer agrees to a fixed rate. The consumer should be allowed to pay off at that rate without any arbitrary charges.

Another issue that we are concerned about at BankCard Holders is low minimum payments. Credit card issuers have been lowering the minimum payments in tiny levels and it creates an expensive trap for customers.

I have an ad which is also in your testimony and it is talking about how Montgomery Ward is lowering the minimum payment to its credit cards and it is all over the ad. They say: Now you can buy more because you pay less. But if you borrow the $800 that they recommend in the ad, it will take you 7 years to pay it off and it will cost the consumer $647 in interest.

Very few consumers have any idea that the time to pay off can take that long and it will cost that much in interest.

Let me conclude by saying there are several provisions in this bill that we strongly support. But I want to make a general statement about why this legislation is needed.

Chairman KENNEDY. I am sorry, but you are well over your 5 minutes, and we have to be fair to everybody else.

Ms. DETWEILER. OK.

[The prepared statement of Ms. Detweiler can be found in the appendix.]

Chairman KENNEDY. Thank you. It was excellent testimony.

Our next witness is Frank O'Leary, who is the treasurer of Arlington County, Virginia. He has received numerous accolades since assuming the position of treasurer in 1983.

Under Mr. O'Leary, Arlington County has achieved the lowest tax delinquency rate in all of Virginia and the county's lowest rate in recorded history.

Thank you very much for being with us. It is good to see you again.

STATEMENT OF FRANK O'LEARY, TREASURER, ARLINGTON COUNTY, VA

Mr. O'LEARY. Mr. Chairman, members of the subcommittee, I am Frank O'Leary, the elected treasurer right across the river. I would like to thank Congressman Jim Moran for sponsoring this bill and thank you for holding these hearings.

Also Mr. Villafrey, the treasurer of the other Arlington, the one in Massachusetts, asked me to express his kind regards.

As an elected official, it is my intense desire to ensure that the citizens of Arlington receive the highest level of government services, at least cost. Further, I seek to maximize their convenience in the area of revenue collection to make the process as painless as possible. I believe the enactment of H.R. 2175 would vitally enhance my service to the public, and that of local finance officers across the Nation.

Mr. Chairman, it is with these objectives in mind that in 1985, I instituted our program of payment by credit card. Since then, Arlington County has become the most intense user of credit cards for payment of government bills in the United States.

During the last fiscal year, more than 12,000 payments totaling more than $4 million were processed. This is a far greater volume than that realized by jurisdictions many times Arlington's size.

Since the inception of our program, the service fee for use of the card has been borne by the cardholder. This is a departure from the practice in the private sector where the business establishment pays the so-called merchant fee and passes on the costs of doing so to all its customers.

Over the last 9 years, not one of the many thousands of Arlington taxpayers served by the Credit Card Program has complained to me over having to pay the fee. They realize that paying a small processing fee is far preferable to paying a large late payment penalty.

By offering credit card services, we have improved the financial situations of many Arlington citizens, reduced fines and penalties which they might have otherwise incurred. Unlike a private business, we did not introduce credit cards as a means of payment in order to increase our revenues or to meet the challenge of a competitor. This is because most of our revenues arise from "mandatory payments."

A mandatory payment is a tax, license fee, permit fee, or other bill which a citizen is absolutely obliged to pay. Accordingly, the volume of mandatory payments is virtually unaffected by whether or not a credit card is employed.

When the payment is not received in a timely manner, the citizen suffers the consequences by the imposition of late payment penalties and subsequent enforcement actions. Mandatory payments are essential to ensure that the government receives the funds necessary to provide police and fire protection, education, and other vital services for the people.

By contrast, governments might also decide to provide non-essential goods and services which citizens might purchase on a "voluntary basis." Recreation, day care, adult education, and the sale of miscellaneous items are all cases where the government acts as a "merchant."

Further, as in the case of a merchant, the level of associated revenue may be positively affected by allowing credit card charges, and involvement by the citizen is absolutely voluntary. In Arlington, the credit card service fees for all such voluntary payments are borne by the government. In short, when government chooses to act as a merchant, government should be treated as a merchant and should absorb the cost of credit card fees.

A departure from these principles on the part of government is logically unsound and politically untenable. Based on a recent national survey, the average credit card fee applied by VISA/MasterCard to government-based credit card transactions is approximately 3 percent. Imagine then a citizen arriving at my office, credit card in hand, with a $1,000 real estate bill, a bill that he must pay and a bill that I must collect, regardless of the payment method.

Mr. Chairman, what possible justification is there for me to incur a charge of $30 to receive a payment which must be made in any event or, if late in payment, must be collected by me with an additional penalty of $100. How could acceptance of such excessive

costs by myself or any treasurer be defended by the overwhelming majority of the taxpayers, also known as voters, who choose to pay their tax bill by check or cash, where the attendant processing cost is measured only in pennies.

Multiply this concept. What happens if a taxpayer walks in with a $10,000 tax bill? A tax bill which he chooses to put on his credit card, which will incur a payment to VISA/MasterCard of $300 for the benefit of receiving such a $10,000 payment which I would have received in any event.

I want to look at the other end of the spectrum. Those people who simply lack the funds to pay their taxes on time. What VISA/MasterCard has done is impose great misery on these people. They have been unable to pay because VISA/MasterCard has deliberately and systematically gone around the United States putting hundreds of local and State governments out of the credit card business. The result of this has been considerable suffering for these individuals, the imposition of penalties, lack of self-respect that comes with being tax delinquent.

Mr. Chairman, I ask you and the other members of this subcommittee to enact this vital legislation. By doing so, you will benefit all Americans.

Thank you.

[The prepared statement of Mr. O'Leary can be found in the appendix.]

Chairman KENNEDY. Thank you very much, Mr. O'Leary, for excellent testimony.

Next is Andrew L. Cheskis, the senior vice president of Franchise Management for MasterCard International. In this capacity, Mr. Cheskis is responsible for policies and practices related to the membership in MasterCard and the use of the MasterCard brand on a worldwide basis.

If you could, Mr. Cheskis, in your oral testimony please address some of the issues that Mr. O'Leary brought up in terms of the practices that he alleges that you pursue.

Please proceed for 5 minutes.

STATEMENT OF ANDREW CHESKIS, SENIOR VICE PRESIDENT, FRANCHISE MANAGEMENT FOR MASTERCARD INTERNATIONAL

Mr. CHESKIS. Thank you.

Mr. Chairman and subcommittee members, I am Andrew Cheskis, senior vice president, Franchise Management for MasterCard International. I am honored to present MasterCard's views on H.R. 2175.

In the interest of time, I will make brief remarks and ask that my full statement be included in the record.

Chairman KENNEDY. Without objection, so ordered.

Mr. CHESKIS. MasterCard has established a series of rules for all who accept MasterCard cards. These rules are intended to fulfill our cardholder's reasonable expectation that their cards will be honored in a uniform and nondiscriminatory manner by all who accept MasterCard cards.

Our "no surcharging" policy in particular ensures that our cardholders are not forced to pay more than the posted price when they use their MasterCard cards.

Credit card payments create significant efficiencies for merchants, such as reducing losses from "bounced" checks and providing funds more quickly than other payment forms. Such savings reduce and can offset entirely the costs of any merchant discount and thus cast serious doubt on the justification for surcharges.

The "no surcharge" rule has, in effect, been endorsed by Congress in the past when it prohibited credit card surcharges. This Federal surcharge prohibition applied to all credit card transactions, by government entities as well as private retail merchants.

Although this Federal surcharge prohibition lapsed in 1984, the rationale for the prohibition is still valid. Therefore, we believe that H.R. 2175 is unjustified and anticonsumer.

H.R. 2175 also raises a number of other serious issues. For example, the bill contains no limitations on the circumstances under which government agencies can impose credit card surcharges. Nor does it specify what constitutes a "government agency."

If entities that compete with private businesses, such as State-run retail outlets, are permitted to surcharge, then privately owned competitors may insist that they too be permitted to surcharge. As a result, consumers may end up paying many more surcharges than Congress intended.

In addition, the bill contains no limitation on the amount of the surcharge that could be imposed on any consumer. It does not even require that there be any relationship between the size of the surcharge and the cost of that credit card transaction to the government agency.

The bill, by allowing government agencies to surcharge credit cards when surcharges are prohibited for virtually all other payments, will result in consumer confusion and complaints.

The bill also would create significant potential for bankruptcy abuse, since credit card debts are dischargeable in bankruptcy filings, and many taxes are not dischargeable debt.

In sum, H.R. 2175 introduces many uncertainties and inequities and challenges the basic integrity upon which the MasterCard credit card system has been founded. MasterCard believes that each credit card company should be free to establish its own surcharge policy, and that government agencies should be allowed to decide for themselves which, if any, cards to accept. The surcharge issue is best addressed through this traditional competitive process.

Mr. Chairman, I thank you for this opportunity to offer MasterCard's concerns about H.R. 2175 and will be happy to answer any questions.

[The prepared statement of Mr. Cheskis can be found in the appendix.]

Chairman KENNEDY. Thank you very much, Mr. Cheskis.

Our next witness is Linda Mock, group vice president for market development, VISA International. Ms. Mock is responsible for marketing, opportunity development, and payment services.

We thank you for being here and we look forward to your testimony.

Please keep it to 5 minutes, and please address if you could some of the concerns that have been raised about your company's policies.

STATEMENT OF LINDA MOCK, GROUP VICE PRESIDENT OF MARKET DEVELOPMENT, VISA INTERNATIONAL

Ms. MOCK. Thank you, Mr. Chairman.

Mr. Chairman, members of the subcommittee, my name is Linda Mock. I am group vice president for market development of VISA. I appreciate the opportunity to testify on H.R. 2175.

Since we have submitted written testimony for the hearing record, I would like to highlight some of our main concerns.

VISA strongly opposes the bill for several reasons. On public policy grounds, the government should not intervene in a market that is demonstrably efficient, is without any evidence of market failure, delivers value to consumers, and where the parties affected, especially government agencies, have perfectly adequate methods to accept cards today within the VISA rules.

Payment card surcharges at the "point-of-sale" harm the VISA product by discouraging usage and by causing consumer confusion as to when and where surcharging is permitted.

We believe surcharges are anticonsumer, discriminating especially against those who may not have the means to pay their obligations with check or by cash. In fact, by permitting surcharges, the bill actually penalizes consumers who pay by card.

Today, about 2,000 government entities do take credit cards in a consumer-friendly manner without surcharges. They have done so by working with our financial institutions and have developed alternatives that accommodate both parties' needs.

The key is that when banks sign merchants for VISA card acceptance, they are free to negotiate any financial arrangement they choose. VISA imposes no restrictions on the financial arrangement between any merchant and its bank partner, except that surcharges aren't permitted.

The government markets are very important to VISA, and while we oppose surcharges, we are working with all sectors of government to find solutions that will facilitate card acceptance.

The value of our product would be harmed if customers were required to pay a surcharge for using it. Passing all of the costs on to the consumer as a surcharge, diminishes the value of card products by decreasing their utility as a substitute for cash and checks.

These other payment methods are used at no charge, of course, to the consumer. All forms of payment, including cash and checks, have costs associated with them. Indeed, credit card costs are often comparable to check costs, yet surcharges require card users to pay not only for the cost of card acceptance but, in essence, for the costs of handling and issuing checks as well. Like the costs of cash and checks, the cost of accepting cards should be treated as a general cost of doing business, as a general cost of operation.

Surcharges offer agencies the illusion of a quick fix, but more creative, efficient consumer-friendly responses, such as those adopted in the private sector, would be more appropriate.

Government acceptance of credit cards is an excellent way to use advanced technologies to enhance and simplify the government

payment process. However, permitting agencies to levy a surcharge on consumers who choose, after all, to take advantage of this convenient payment method, is not likely to encourage use.

In addition to payment services, State and local government units use and pay for a wide variety of financial services in performing their public missions, such as bond underwriting, investment management, and cash management. Why should credit card acceptance be different?

In conclusion, I would like to emphasize that VISA believes the proposed legislation is not in the best interest of consumers, government agencies themselves, or certainly the members of the payment card industry.

I would be pleased to answer any questions the subcommittee might have.

[The prepared statement of Ms. Mock can be found in the appendix.]

Chairman KENNEDY. Thank you very much, Ms. Mock.

Our final witness of the panel is Jeffrey Esser, the executive director of the Government Finance Officers Association, serving government finance professionals from city, county, and State governments from the United States and Canada.

We thank you for being here and look forward to your testimony.

STATEMENT OF JEFFREY ESSER, EXECUTIVE DIRECTOR, GOVERNMENT FINANCE OFFICERS ASSOCIATION

Mr. ESSER. Thank you, Mr. Chairman.

I am also here on behalf of seven other organizations of State- and local-elected and appointed officials from all 50 States in support of H.R. 2175.

Since every other witness seems to have been speaking for the consumer, I guess all of the State- and local-elected officials can claim that same right as, of course, you as elected officials can as well.

However, in this era of reinventing government and making government more efficient, State and local governments are looking for ways to improve service to their citizens and to address their concerns.

Many of our citizens have requested that their jurisdictions allow more convenient, quick, and flexible methods of payment for governmental charges that enable them to avoid late payment fees and stretch their payments out over time. At the same time, State and local governments are also attempting to minimize the costs of collecting and processing payments from their citizens and to expedite deposit of these payments into their accounts. As a result, governments across the Nation are offering the option of payment by credit card.

The most frequent uses are for fines, motor vehicle registration and licenses, recreation services, parking fees, and tax payments. It is estimated that approximately $300 billion is paid annually to governments for fines and fees, a potentially enormous market for the credit card companies seated at this table.

Despite the growing interest in payment by credit card and the technology that makes it possible, the two largest credit card companies—not Discover, but the other two that are here today—pro-

hibit governments and businesses from passing on surcharges imposed by the card companies to those consumers who elect to pay by credit card.

With fees ranging from 1.5 to 3 percent, State and local governments find it difficult to absorb the added expense involved. Because governments, unlike businesses, are restricted by statute from adjusting charges to their citizens to cover the high credit card surcharges and fees, all taxpayers, all consumers, even those who do not use this payment option, must be assessed higher taxes to cover these costs.

As a matter of public policy and consumer protection, State and local governments believe it is unfair to force all taxpayers to bear the cost of a service that may only be utilized by a small portion of taxpayers. Despite the assertion of VISA and MasterCard that their policy is designed to protect consumers, we maintain that this policy instead is clearly anticonsumer and antitaxpayer.

The State and local governments represented here today occupy the true proconsumer position. Passage of this bill would allow us to provide various payment options with full disclosure regarding additional fees. Some of the suggestions that Congressman Moran and Ms. Detweiler suggested this morning would certainly make the bill a better bill.

Mr. Chairman, VISA and MasterCard and their allies have advanced a number of arguments in opposition to allowing State and local governments to pass on those fees. While they are dealt with in detail in our written testimony, these arguments fail to recognize the essential differences between the private and the public sectors.

Because of the nature of tax payments, the ability to pay by credit card does not increase demand for services, cannot add to a government's profit margin, cannot increase discretionary spending, and doesn't lead to early payment. Our citizens are required by law to be notified of any increases in governmental charges and have no difficulty understanding that they may incur additional charges if they choose the credit card payment option.

In addition, if these fees are assessed, they would have to be proposed at the State and local level. There would be public hearings and there are also usury laws in all 50 States that would prevent some of the fears that I have heard about this morning.

We admit, however, that we are mystified by the one exception that the credit card companies allow for gambling casinos and truck stops to assess surcharges on their credit cards.

Mr. Chairman, we urge the subcommittee to approve H.R. 2175 with some of the suggestions that have been made this morning. In an era where governments at all levels have recognized the need to serve our citizens more efficiently and with less expense, the State and local government groups represented here today urge this subcommittee to allow us to carry out our responsibilities to our citizens, our taxpayers, and the consumers all across the United States in a fair and equitable manner.

Thank you for allowing us to present our testimony this morning.

[The prepared statement of Mr. Esser can be found in the appendix.]

Chairman KENNEDY. Thank you.

I want to thank all the witnesses for your testimony this morning. You have given us a good and balanced view of some of the issues that we have to struggle with as we look to acting on this legislation.

I will refrain from asking questions, in the interest of time.

I would like to recognize Mr. McCandless for any questions that he might have.

Mr. McCANDLESS. Thank you, Mr. Chairman.

I would like to submit to the panel some questions in writing which we will then use for the record purposes.

Chairman KENNEDY. Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

I came in late and I apologize for that. I had another hearing this morning.

I don't have any questions, although I am interested in knowing how an exception can be made for gambling casinos and not for local governments. I would like to understand the policy rationale and justification for that.

Chairman KENNEDY. Well, do you want to ask the question? We have time to get it in now.

Mr. WATT. Maybe somebody could give me a little briefing on that, and whether if we don't pass this bill, we might consider a requirement that no exceptions be made in the policy.

Chairman KENNEDY. Ms. Mock, would you like to address that subject?

Ms. MOCK. I will speak to that.

That is a practice of long standing and involves wire-transfer money orders, where really what the cardholder is doing is not obtaining service from the merchant but obtaining cash. And we have moved to restrict that and virtually eliminate it from all other practices that are beginning to grow in that practice. And as a result, it will be grandfathered for some period of time, but the intent over time is to eliminate it.

Mr. WATT. Over what time?

Ms. MOCK. The problem is there are parties involved who are in business and we have to move carefully, because you can't shut a business down. But presumably, the horizon would be something on the order of 3 or 5 years.

Mr. WATT. Any other responses to that?

I am not sure I am convinced yet that just because it has been done that way in the past, that it necessarily has to be done that way in the future. That is what I understand to be your response.

Mr. CHESKIS. If I may, I guess I will just add that this was a longstanding practice. We looked at this a year ago in MasterCard and found that this practice has been going on for more than a decade.

Mr. WATT. Is there some policy justification for that other than the fact that it has been going on for a long period of time?

Mr. CHESKIS. It is important to understand that we have an enormous system with 11 million merchants worldwide, spanning the globe. Although we very actively ensure compliance with our rules, occasionally we come across noncompliance and we seek to address it.

In this particular case, we found it was a decade-old or more practice. We didn't believe at the time we looked at it that it was warranted to change the way that this industry has conducted itself for over a decade, so for the time being, we limited the scope of the exception to those two particular industries.

Mr. WATT. This is a decade-old noncompliance with rules or it is a decade-old policy that you have to exempt these businesses?

Mr. CHESKIS. It was the former. It is a decade-old practice which did not comply with our rules. When we evaluated our rules and how the card is accepted at point-of-sale, we found some noncompliance and we acted to shut those down in a very aggressive manner.

We found this one case to be a decade-old industry practice and, frankly, we did not have a significant number of objections about this particular niche. While we hear consumer complaints about surcharges all the time, this particular niche is not one where we heard complaints. And so we didn't believe it was warranted to change the way that this business has conducted itself for over a decade.

Mr. WATT. You acknowledge this is a noncompliance with your policy and you are still going to give them 3 to 5 years to comply?

Mr. CHESKIS. When we reassessed our rules and our policies in this area, we aggressively reaffirmed our "no surcharges" policies and other policies to protect the MasterCard brand and the consumer at the point-of-sale, and we sought to shut down those who were out of compliance. In this particular case, we modified our rules to permit these two very narrow exceptions for the time being, so they are in compliance at this time.

Chairman KENNEDY. Mr. Watt, if you wouldn't mind.

Mr. WATT. I am finished.

Thank you.

Chairman KENNEDY. Thank you.

They were excellent questions.

I now would like to turn to Mr. Castle, who has waited patiently and I know had another hearing he had to run to.

Mr. CASTLE. Now we have a vote instead.

I was struck by what Ms. Detweiler said in terms of my State, which has attracted a lot of credit card companies to Delaware, and I don't have a question because we don't have time to ask the questions.

But I would like quickly—I am not that familiar with Mr. Schumer's legislation, but it seems to break down into separate categories with a number of different requirements.

I would be interested in hearing from all of you or your organizations in terms of those things which you think you cannot live without or with which you think you cannot live, depending on how you look at it, in some sort of rank order, or those things that are particularly difficult for you to comply with.

Mr. Vague, in the case of your operations or those things which the consumers really need—not to be the mediator, but as these bills are considered things tend to get left off or added on, or whatever it may be. And I would be curious as to what are truly the most objectionable or desirable aspect of the legislation. I don't ask for an answer now, but I would like to receive that information for the record.

Chairman KENNEDY. Thank you very much.

I want to thank all the members of the panel.

There being no further questions, I want to express my appreciation to all of you for your excellent testimony.

I would like to ask unanimous consent that the record be kept open for a period of 4 weeks so that additional views may be submitted.

Hearing no objection, it is so ordered.

The panel is excused and the subcommittee is in recess.

Thank you.

[Whereupon, at 11:22 a.m., the subcommittee was adjourned.]

A P P E N D I X

February 10, 1994

CHAIRMAN JOSEPH P. KENNEDY II

FEBRUARY 10, 1994 HEARING -- OPENING STATEMENT

THE SUBCOMMITTEE WILL PLEASE COME TO ORDER.

THIS MORNING, THE SUBCOMMITTEE CONSIDERS TWO BILLS THAT FOCUS OUR ATTENTION ON THE CREDIT AND CHARGE CARD INDUSTRY. THEY ARE AUTHORED BY TWO OF THE CONGRESS' MOST DISTINGUISHED MEMBERS, CHUCK SCHUMER AND JIM MORAN. BOTH OF THESE MEMBERS HAVE BEEN SOLID FRIENDS TO CONSUMERS OVER THE YEARS. MR. SCHUMER IS A LEADER ON THE BANKING COMMITTEE IN EFFORTS TO PROTECT THE ORDINARY CITIZENS OF THIS COUNTRY. AND CONGRESSMAN MORAN, ALTHOUGH NO LONGER ON THE COMMITTEE, CONTINUES TO SPEAK ON BEHALF OF THE PEOPLE WHOSE VOICE IS TOO LITTLE HEARD IN THE HALLS OF CONGRESS.

BOTH OF THESE MEMBERS HAVE BROUGHT TO OUR ATTENTION SEVERAL PRACTICES IN THE CREDIT CARD INDUSTRY THAT DESERVE THE SUBCOMMITTEE'S SCRUTINY. FOR EXAMPLE, CREDIT CARD INTEREST RATES CONTINUE TO BE TROUBLINGLY HIGH. ACROSS THE COUNTRY, THE AVERAGE IS ABOUT 16 AND 1/2 PERCENT, AND SOMETIMES AS HIGH AS 22 OR 24 PERCENT. THESE RATES ARE LOWER IN ABSOLUTE TERMS THAN A FEW YEARS AGO, WHEN AVERAGE RATES HIT 19.5%. HOWEVER, THE SPREAD BETWEEN CREDIT CARD RATES AND STANDARD RATES -- LIKE THE RATE FOR 30-YEAR TREASURIES -- IS ACTUALLY HIGHER THAN IT WAS IN THE ROARING 1980'S. SO CREDIT CARD CONSUMERS -- FOR REASONS THAT AREN'T CLEAR -- HAVEN'T REAPED THE BENEFITS OF THE CURRENT LOW INTEREST RATE CLIMATE.

SECONDLY, IT APPEARS THAT CONSUMERS ARE BEING HURT BY UNEXPECTED CHANGES IN CREDIT CARD INTEREST RATES. CARDHOLDERS ARE FINDING THAT THEIR RATES ARE GOING UP EVEN THOUGH THEY'VE BEEN PROMISED "FIXED" RATES. TO MAKE MATTERS WORSE, THE HIGHER RATES

ARE BEING APPLIED TO OUTSTANDING BALANCES -- MEANING MONEY THEY'VE **ALREADY** BORROWED. ITS HARD TO SEE THE FAIRNESS OF THIS PRACTICE.

THIRDLY, CARDHOLDERS APPEAR TO BE FALLING, UNKNOWINGLY, INTO DEEPER DEBT BECAUSE OF MISLEADING INFORMATION PRINTED ON THEIR BILLING STATEMENTS. RIGHT NOW, 72% OF ALL CARDHOLDERS OWE AN OUTSTANDING BALANCE AT THE END OF THE MONTH. THEY KNOW THAT THEY CAN KEEP THEIR ACCOUNTS CURRENT BY MAKING A VERY SMALL MONTHLY MINIMUM PAYMENT -- AS LITTLE AT 1% OR LESS OF THE TOTAL AMOUNT OWED. WHAT THEY **DON'T** KNOW IS THAT IT COULD TAKE THEM YEARS TO PAY OFF THEIR OBLIGATION, AND AT SKY-HIGH RATES. AN $1100 BALANCE ON A CHASE BANK CARD WITH A 19.8% RATE, FOR INSTANCE, WILL TAKE **15** YEARS TO PAY OFF PAYING ONLY THE MINIMUM MONTHLY AMOUNT. TOTAL INTEREST ON THAT $1100 DEBT WOULD EXCEED $1800 -- OVER **1 AND 1/2** TIMES THE PRINCIPLE! THE QUESTION WE'VE GOT TO ASK IS WHETHER OR NOT CONSUMERS WOULD GO THIS ROUTE IF THEY KNEW HOW LONG AND HOW MUCH IT WOULD TAKE.

FINALLY, THE SUBCOMMITTEE HAS BEEN TOLD THAT CREDIT CARD COMPANIES ARE RELUCTANT, IF NOT DOWNRIGHT HOSTILE, TO ALLOWING CONSUMERS TO PAY STATE AND LOCAL DEBTS BY CREDIT CARD. APPARENTLY, THEY DON'T LIKE THE FACT THAT GOVERNMENTS WANT THE OPTION OF CHARGING A FEE TO CONSUMERS WHO DECIDE TO PAY BY CREDIT CARD, BECAUSE IT MIGHT MAKE THAT METHOD OF PAYMENT LESS ATTRACTIVE THAN OTHERS. THIS IS CERTAINLY AN ISSUE THAT DESERVES TO BE EXPLORED. WE DON'T WANT TO LOSE AN OPPORTUNITY TO ALLOW A METHOD OF PAYMENT THAT'S MORE CONVENIENT FOR BOTH CONSUMERS AND GOVERNMENTS, WITHOUT IN ANY WAY CUTTING INTO THE RETURN FOR THE CARD COMPANIES.

BOTH CONGRESSMAN SCHUMER AND CONGRESSMAN MORAN HAVE CRAFTED

THOUGHTFUL LEGISLATION DESIGNED TO RESPOND TO THESE PRACTICES IN THE MARKETPLACE. MR. SCHUMER'S BILL, H.R. 1842, WOULD PROVIDE ADDED DISCLOSURE OF INTEREST RATES, IN THE HOPE THAT IT MIGHT GENERATE SOME COMPETITION AND DRIVE THOSE RATES DOWN. HE WOULD TRY TO HELP CONSUMERS AVOID THE STING OF SUDDEN RATE HIKES BY ALLOWING THEM TO PAY OFF A CREDIT CARD DEBT AT THE ORIGINAL TERMS. AND HIS BILL WOULD MAKE SURE CONSUMERS KNOW HOW MANY MONTHS, AND HOW MUCH INTEREST, IT WOULD TAKE TO PAY OFF A CARD DEBT AT MINIMUM MONTHLY LEVELS. MR. MORAN'S BILL, H.R. 2175, IS VERY MUCH IN THE SPIRIT OF THE SCHUMER BILL. IT WOULD ALLOW CONSUMERS TO PAY THEIR GOVERNMENT OBLIGATIONS BY CREDIT CARD, AND ALLOW GOVERNMENT'S TO CHARGE THEM THE COST OF THAT SERVICE.

THE SUBCOMMITTEE IS FORTUNATE TO HAVE BOTH MR. SCHUMER AND MR. MORAN WITH US THIS MORNING, AS WELL AS OTHER WITNESSES WHO ARE WELL-QUALIFIED TO DISCUSS THEIR BILLS. I LOOK FORWARD TO HEARING THEIR VIEWS ON WHAT WE CAN DO TO ENSURE THAT CONSUMERS GET THE INFORMATION AND OPTIONS THEY NEED TO MAKE INFORMED CHOICES.

WITH THAT, LET ME TURN TO MR. MCCANDLESS FOR AN OPENING STATEMENT.

STATEMENT OF REP. CHARLES E. SCHUMER

BEFORE

THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

ON H.R. 1872

February 10, 1994

Thank you, Mr. Chairman, for holding this hearing on what I think everyone can agree is a very important issue: credit cards. Your leadership in consumer issues is renowned and I appreciate this opportunity for an in-depth look into this important legislation.

Let me begin by posing a simple question: Why doesn't the credit card industry like my bill? All my bill does is require the credit card industry to keep their cardholders informed. Under my bill, credit card companies would:

* provide a monthly disclosure that lets consumers know what they are paying on their card in principle and interest charges, and a yearly statement that tells them what their card cost to use in interest and fees;
* make it clear in advertisements what their rates and fees are;
* tell consumers when they will be raising the card's interest rate and let the consumer cancel the card and pay off the balance at the old rate if they don't like the new deal; and
* tell cardholders if they will be selling information about them to

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direct marketers and give consumers the chance to "opt out" of these programs.

Maybe the reason credit card companies don't like my bill is because with real disclosures consumers would know that they are being taken for a ride. Consumers would know that their credit cards cost them more to use than almost any other source of financing, aside from loan sharks.

Now, I know that the credit card industry of today is a more competitive industry than it was even two or three years ago. The deals abound - some cards with lower rates, no annual fees, "affinity" cards that let you earn frequent flyer miles. And I know that interest rates have come down some, especially in the last year or two. <u>But the average rate on credit cards is still 16.5%!</u> The prime rate is only 6% and the difference between the two has <u>increased</u> in the last 10 years. Is that the benefit we have reaped from a more competitive industry?

To illustrate my point about how high rates are, in both relative and absolute terms, I have taken a page from Ross Perot and brought a chart along.

I have tracked the prime interest rate, the average home mortgage fixed rate, and the industry average for credit cards over a period of 10 years. The prime dropped from 12.0% in 1984 to 6.0% right now in

1994; home mortgages dropped from 12.38% in 1984 to 6.97% as of last Saturday, February 5th.

But what about credit cards? Well, they too dropped but not nearly as much and not nearly as fast. They went from 18.75% in 1984 to . . . 16.5% today -- a whopping drop of 2 and one quarter percentage points!

The question is why?

Surveys have shown that most consumers are flying blind -- many don't know the interest rate their credit cards charge. And there is no easy way for them to know how much the interest and fees are adding up to -- month after month after month. If there was, consumers would be more likely to shop around for a better deal -- and there are better deals out there. Maybe that's why credit card companies don't want us to know what they are charging. My bill would provide that information to them.

Last Friday, we saw short term interest rates inch up a quarter of a percent, the first rise in five years. Both Alan Greenspan and Laura Tyson predict rising interest rates this year. This means we'll probably see interest rates on variable rate cards going up. Something tells me interest rates on variable rate credit cards will be more responsive to <u>increases</u> in the prime rate than they have been to decreases. If that occurs, consumers must be notified in advance and have a chance to drop their cards if they don't like the new deal their bank offers.

Mr. Chairman, you will probably hear from the industry representatives who follow me here today about how the disclosures in my bill would cause credit card interest rates to go up. I'm sure you saw the commentary in today's American Banker trying to make this point ad naueaum and pointing to a study that shows how healthy the credit card market is. That study is a PR campaign bought and paid for by the industry. It has as much credibility as tobacco industry studies proclaiming the healing powers of cigarettes.

The credit card business is a multi-billion dollar industry and it spends millions of dollars in advertising to entice consumers to carry their cards. A few simple disclosures are not going to drive up rates. That is just not plausible. I think that what the credit card industry is afraid of is that the disclosures in my bill would drive down rates.

Mr. Chairman, I thank you for holding this hearing. I know that you share many of these same concerns. Your leadership in this area is to be commended and will go a long way in leveling the playing field for consumers. I look forward to working with you in the future on this important issue.

COMMITTEE
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Testimony of
The Honorable James P. Moran

before the

House Banking, Finance and Urban Affairs
Subcommittee on Consumer Credit and Insurance

February 10, 1994

Mr. Chairman and Members of the Committee, thank you for scheduling this hearing.

This hearing could not be more timely. Vice President Al Gore has recently called for allowing the IRS to accept income tax payments by credit card. At the same time, state and local governments, which have taken the lead in accepting payments by credit card, are being forced to ceased their operations because of actions taken by the major credit card companies.

It was once noted that "state and local governments are the laboratories of democracy." With regard to the issue at hand, state and local governments have been more responsive to public expectations and needs than the federal government.

State and local officials know that the public demands that they operate as efficiently and effectively as the private sector. The people expect public services to be convenient, quick, and complete.

Given the option, many people would prefer to register their car or pay their real estate and property taxes over the telephone with a credit card.

It's quick, convenient and spares people the time and expense of visiting the motor vehicle or tax office and spending their time waiting in long lines.

Payment of taxes by credit cards has an added consumer benefit of enabling taxpayers to avoid the stigma and added expense of late tax payments, since card holders can avoid the late penalty fee and stretch their payments out over several months.

When the public is provided this option to pay by credit card and informed that this type of payment will cost a little more, their decision to use a credit card is an informed choice.

The majority of the public is motivated the same way as customers who elect to purchase products from mail order catalogues are motivated. Convenience outweighs the additional shipping expense.

Unfortunately, state and local efforts to provide this convenient option have run into a brick wall constructed by the major credit card companies.

In recent months, VISA and Mastercard have orchestrated a concerted effort to shut down credit card operations in state and local government agencies imposing a surcharge on the credit card transaction.

They have accomplished this task by imposing heavy fines on banks which processed the credit card transaction. Faced with tne threat of fines as high as $100,000, the banks were to forced cancel their arrangement with the local government.

The entire problem arises from the failure of the major credit card companies to distinguish between public agencies and department stores and restaurants.

Commercial enterprises, which accept payment by credit card, are prohibited by VISA and Mastercard's bylaws from passing the cost of credit card transactions directly onto the customer.

Merchants spread this cost among their entire customer base through higher prices. Few merchants complain because they can recoup this expense by selling more of their products or services. Conversely, not accepting credit cards may result in less business.

Most customers buy more on credit than they can pay with cash. Walk into any clothing store and try to buy just a tie or silk scarf with cash. If the merchant is doing a good job, chances are, he or she won't let you leave the store without talking you into buying the matching suit as well.

Public agencies, however, operate very differently. The Treasurer of Arlington County, Virginia, cannot ask the taxpayers, who choose to pay by cash or by check to help absorb the added cost of taxpayers who choose to pay by credit card.

The California Division of Motor Vehicles can not recoup the service charge paid to credit card companies on each transaction by inducing citizens to register more vehicles. The number of vehicles registered by a government entity will not be affected by the method of paying the registration fee.

Moreover, state and local law may prohibit or restrict public agencies from absorbing or spreading this cost.

The numbers present a very convincing argument.

If the Internal Revenue Service were to accept income tax payments by credit card, it could not absorb the 2 percent surcharge charge VISA and Mastercard demand on each credit card transaction.

Under Mastercard and VISA's policy, the IRS would have to absorb the $200 million in service charges on $10 billion worth of credit card tax payments. Who in this room would advocate raising taxes by $200 million to cover the cost of this service? This is clearly unacceptable.

The issue is just as significant for state and local governments.

In the instance of mandatory government payments, those the public must bear or face the consequences of fines, penalties, and possible imprisonment, the government will collect the money with or without credit cards.

All these governments are trying to do is provide the public with a convenient option for paying these obligatory demands. An option that, in many instances, can help the public avoid late payment penalties.

Most state and local governments, as well as the federal government impose a 10 percent penalty for late payments. Failure to pay a $1,000 tax bill by the deadline will result in an immediate $100 penalty.

If, however, the taxpayers were able to put their $1,000 tax payment on their credit card, their immediate tax bill would be $1,020. A savings of $80.00 including a $20 surcharge.

Even if the same individual were to stretch the payment out over six months at credit card's 18 percent interest rate, he or she would still save money by avoiding the government imposed penalty plus interest.

Mr. Chairman, the legislation I have introduced would merely permit federal, state and local government agencies to pass the cost of the credit card transaction on to the customers who elect to pay by credit card.

VISA and Mastercard would not suffer any loss. Only the manner in which the surcharge is collected would be changed.

If they argue that it cannot be done, they need only look over their shoulders to watch Discover Card pick up contracts with state and local government agencies whose credit card operations were shut down by VISA and Mastercard. These agreements between Discover Card and the local governments clearly permit the surcharge to be borne by the credit card holder.

In fairness to the credit card industry, I have expressed my interest in working with the industry to address their concerns.

I am willing to work with this committee to limit the scope of my legislation to only those payments that are mandatory. When the government operates like a merchant and sells optional products, like a fishing license, a recreational class, etc., it should swallow the cost of the transaction.

I am also willing to provide additional consumer safeguards to ensure that no government agency could turn the surcharge into a revenue enhancement mechanism and skim credit card holders for more than what VISA and Mastercard collect.

Mr. Chairman, thank you again for conducting this hearing. I look forward to working with you and the Committee to enact this important, timely legislation.

Organizations Supporting
Credit Card Reform Legislation (H.R. 1275)

American Association Motor Vehicle Administrators

Federation of Tax Administrators

Government Finance Officers Association

Municipal Treasures' Association

National Association of State Auditors, Comptrollers and Treasurers

National Association of Counties

National Association of County Treasures and Finance Officers

National Association of State Treasurers

National League of Cities

STATEMENT OF

MASTERCARD INTERNATIONAL INCORPORATED

AND

VISA U.S.A. INC.

BEFORE THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

ON H.R. 1842

AND

COMPETITION IN THE CREDIT CARD INDUSTRY

FEBRUARY 10, 1994

VISA U.S.A. Inc. ("VISA"),[1] and MasterCard International Incorporated ("MasterCard")[2] appreciate the opportunity to appear before the Subcommittee on Consumer Credit and Insurance ("Subcommittee") of the House Committee on Banking, Finance and Urban Affairs to discuss the intense competition among, and other market forces affecting, members of the credit card industry. We are also pleased to present our views concerning the amendments to the Truth in Lending Act ("TILA") proposed by the Credit and Charge Card Disclosure and Interest Rate Amendments Act of 1993 (H.R. 1842). We request that our testimony be made part of the record of the hearing.

INTRODUCTION

It is difficult to imagine any legislation that is less necessary and would be more counterproductive than H.R. 1842. The proposed "FINDINGS" set forth in section 2 of H.R. 1842 itself indicate that the purported justification for the legislation is predicated on two principal assumptions: (1) the credit card market is not sufficiently competitive; and (2) more disclosure of credit card information to consumers is necessary to increase competition. Both of these assumptions are entirely incorrect.

The profitability of, and competition in, the credit card industry has been the focus of careful examination for many years. Examination of the industry has intensified greatly in recent years with federal agencies, industry groups and independent economists studying every facet of the credit card market in response to Congressional proposals to impose pricing and other restrictions on the industry. Several facts about the credit card industry have been demonstrated and established through this examination process which make it clear that legislative measures such as H.R. 1842 are entirely unnecessary.

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1 VISA is a membership association comprised of financial institutions in the United States which are licensed to use the VISA service marks in connection with payment systems, including credit cards.

2 MasterCard is a membership organization comprised of financial institutions which are licensed to use the MasterCard service marks in connection with payment systems, including credit cards.

1. <u>The credit card industry is one of the most competitive industries in the United States</u>. As the Federal Reserve Board has noted recently, "competition in the credit card market remains intense, with many thousands of firms offering [bankcards] to consumers."[3] Indeed, there are approximately 6,000 banks and other financial institutions in the United States that compete aggressively for customers by offering thousands of different credit card programs.

2. <u>Credit card issuers already provide comprehensive credit card disclosures to consumers</u>. Card issuers already must comply with an exhaustive list of disclosure requirements under existing federal laws such as the TILA, the Fair Credit Billing Act, the Fair Credit and Charge Card Disclosure Act, the Fair Credit Reporting Act and the Equal Credit Opportunity Act, as well as a wide array of state laws. Under the TILA alone, card issuers must disclose key account terms with credit card applications and solicitations, provide additional account disclosures before the credit card is used, and furnish detailed periodic statements to consumers showing account activity for every billing period (typically monthly) that the account remains active. If the account terms are changed, card issuers are already subject to change in terms disclosure requirements under existing federal and state law. Credit card programs also are subject to federal and state advertising rules and numerous other disclosure requirements.

3. <u>Additional disclosures are unnecessary</u>. The disclosures provided to consumers under existing federal and state law already meet or exceed the needs of consumers for credit card account information. In response to research conducted by MasterCard and VISA, consumers indicated that they already receive sufficient information regarding their credit card accounts. The enactment of requirements for additional disclosures on such accounts can only be counterproductive.

4. <u>Additional regulation of the credit card industry actually will be harmful to consumers</u>. It is beyond doubt that additional burdens on the credit card industry, such as those that would be imposed by H.R. 1842, would increase the costs of operating credit card programs. These additional costs would be reflected in higher consumer credit prices and a tightening of lending policies which

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3 <u>The Profitability of Credit Card Operations of Depository Institutions, An Annual Report by the Board of Governors of the Federal Reserve System</u>, at 7 (September 1993).

would decrease credit availability, particularly for lower- and moderate-income families.

BRIEF SUMMARY OF TESTIMONY

When considering any proposal to modify the laws affecting credit cards and credit card issuers, it is important to understand fully the current state of the credit card market. Credit card issuers compete with one another for cardholders more intensely than ever before. The approximately 6,000 banks and other financial institutions, including affiliates of a growing number of diversified companies, that issue VISA and MasterCard credit cards in the United States aggressively compete with one another for a share of the credit card market. No segment of financial services, or commerce generally, is more competitive today than credit cards. This highly competitive environment has resulted in an ever-increasing number of reduced interest rate and reduced fee credit card programs, as well as an increase in the variety of available credit card enhancements and other program features.

Advances in technology and information processing also enable card issuers to better segment and price their credit card accounts based on individual cardholder risk profiles, so that consumers with strong credit histories can qualify for the most attractive accounts.

Credit cards provide consumers with an extremely convenient payment mechanism which can be used to obtain unsecured extensions of credit to purchase goods and services throughout the world. Unlike other types of credit products, bank credit cards offer consumers flexible repayment features which are selected largely at the option of the cardholder. For example, under most bankcard programs, cardholders who pay off their entire balances when billed can receive as much as 40 to 50 days of free credit. Experience demonstrates that the convenience and range of services available through credit cards provide substantial value to cardholders and these factors are very important to cardholders in selecting credit card programs.

In order to provide these credit card programs and services to cardholders, card issuers incur significant costs which are much higher than the costs of operating other types of credit or lending programs. For example, issuers incur substantial operating expenses to establish, expand and maintain the extensive telecommunications and customer service infrastructure necessary to operate these bankcard systems nationally and worldwide. In addition, it is important to note that most credit card debt is unsecured and, thus, involves more credit risk than other forms of

lending, like home mortgages or auto loans. Losses from cardholder bankruptcy filings, and other credit problems, have reached unprecedented levels notwithstanding extensive efforts of card issuers to formulate new procedures to reduce credit risk, without unduly impeding the important availability of consumer credit. Although MasterCard and VISA, and their member financial institutions, have successfully thwarted numerous credit card fraud and counterfeiting schemes, new schemes continue to arise and fraud and counterfeiting losses continue to comprise an undesirably high portion of the cost of operating bank credit card systems.

These increases in operating expenses, credit losses and fraud losses have not been offset by recent reductions in the cost of funds. Unlike other credit products, reductions in the cost of funds have a relatively small impact on the overall costs of operating bank credit card programs because the funding costs of a bankcard program, as a percentage of total costs, are low compared to other types of lending.[4] Thus, decreases in the cost of funds have a greater impact on other lending operations, such as mortgage loans and other installment loans, than they do on credit card lending.

Given the nature of credit card programs which permit cardholders to obtain, at their convenience, principally unsecured extensions of credit over an indefinite period of time, and given the ever-changing economic conditions which affect the cost of operating such programs, it is essential that card issuers retain the flexibility to price their programs based on market conditions. In addition, any government initiatives which increase operating costs will increase the cost of credit cards, and thereby reduce their availability, particularly to lower- and moderate-income families.

It is clear that the amendments to the TILA proposed in H.R. 1842 would have such an impact. Its burdensome and unnecessary requirements would present significant operational difficulties for card issuers, would reduce the value and marketability of credit card portfolios, and would increase the cost and reduce the availability of credit card accounts to consumers.

Moreover, H.R. 1842 would impose enormous new regulatory burdens on an already comprehensively regulated industry. In view of the overwhelming body of federal and state laws the credit card industry already must comply

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4 Robert E. Litan, <u>The Economics of Credit Cards</u> at 4 (January 1993).

with, it simply is not possible to justify imposing on card issuers additional regulatory burdens, such as those that are contemplated by H.R. 1842. Indeed, given the current recognition of the need to reduce regulatory burdens on financial institutions, Congress is presently considering a number of regulatory relief proposals. Those Congressional regulatory relief proposals are intended to reduce precisely the types of burdens that would be created by legislation such as H.R. 1842.

COMPETITION IN THE CREDIT CARD MARKET

A. The Credit Card Environment is Comprised of Thousands of Extremely Aggressive Competitors.

1. Market Structure.

"[T]he credit card issuers' market is highly competitive."[5] Competition among providers of credit card products and services is more vigorous today than ever before. Approximately 6,000 banks and other financial institutions, such as thrifts and credit unions, currently offer some type of "bankcard" credit card program in the United States. These bankcard issuers compete fiercely with each other to retain existing cardholders and attract new customers. No area of financial services is more intensely competitive than credit cards. Card issuers also face aggressive competition from a multitude of other organizations, such as retailers, finance companies, travel and entertainment card issuers, and oil companies that offer credit programs similar to the bankcard products provided by financial institutions.

2. New Entrants.

Moreover, diversified financial and commercial enterprises are entering the bankcard industry at an unprecedented rate. For example, AT&T entered the bankcard business, through Universal Bank, in March of 1990 and already has over ten million bankcard accounts. In less than three years, the AT&T program has become one of the ten largest bank credit card programs in the nation. Greenwood Trust, owned by Dean Witter and issuer of the Discover Card, has more bank credit card accounts than any other issuer in the United States. Manufacturers, such as Ford Motor

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5 Robert E. Litan, Consumers, Competition and Choice: The Impact of Price Controls on the Credit Card Industry at 10 (February 1992); see also David S. Evans and Richard L. Schmalensee, The Economics of the Payment Card Industry at 75 (1993).

Company and General Electric, also compete through subsidiaries for a substantial share of the bankcard business. General Motors, in cooperation with Household Credit Services as card issuer, has launched an enormously successful credit card program which has placed Household among the ten largest card issuers in the country in less than two years. In addition, some of the nation's largest insurance companies, including John Hancock Mutual Life Insurance Company, Travelers Corporation and Prudential Insurance Company, have become significant participants in the bankcard industry, even though Congress continues to deny banks similar access to the insurance markets.

Additionally, as a result of changes in the statutory and regulatory framework governing the banking industry, the number and diversity of competitors in the bankcard business will continue to increase. For example, the Competitive Equality Banking Act of 1987 ("CEBA") amended the Bank Holding Company Act of 1956 ("BHCA") to exempt from the BHCA definition of "bank" so-called "credit card banks" which engage only in credit card operations and adhere to certain deposit taking and other restrictions. As a result, commercial enterprises which are restricted under the BHCA from owning a "bank" may own and operate a CEBA credit card bank and issue bank credit cards. Thus, a company representing virtually any industry in the United States now can enter, and compete in, the bank credit card business. In addition, card issuers in the United States now face competition from card issuers located abroad, such as JCB -- the largest Japanese credit card issuer -- which now issues its JCB credit card in the United States through a newly created credit card bank subsidiary and in a cooperative effort with Household Credit Services. In short, the credit card industry is expanding continuously with more and more issuers competing for cardholders.

B. <u>The Competition in the Credit Card Industry Translates Directly into Consumer Benefits</u>.

1. <u>Competition Drives Down Credit Card Rates</u>.

The fierce competition resulting from the rapidly increasing number of participants in the credit card industry has manifested itself in many ways. For example, the credit card industry clearly is an unconcentrated industry in which even the largest credit card issuers have only a modest share of the market. In addition, competing credit cards from a range of card issuers are available in virtually every market throughout the United States, and most consumers have a wide variety of competing credit card programs from which to choose. As a result, in order to attract new cardholders and retain or expand market share, card issuers aggressively explore new pricing and

"enhancement" combinations to distinguish themselves from competitors. Many card issuers have attempted to attract qualified new customers by offering credit cards with reduced annual percentage rates, no or low annual fees, and a wide variety of special features and enhancements. As the Federal Reserve Board recently explained:

> Credit card issuers, including nearly all of the largest issuers, have reduced interest rates charged to all or significant portions of their customer bases. Some issuers have segmented their cardholder bases according to risk characteristics, offering reduced rates to existing customers who have good payment records while maintaining relatively high rates for higher-risk, late-paying cardholders.[6]

As a result of this intense price competition, credit cards with low annual percentage rates, low or no annual fees, and other favorable terms are more widely available today than ever before.

2. Competition Generates Other Discounts and Additional Features.

The current competitive battles in the credit card market, however, are by no means limited to competition over annual percentage rates. Many card issuers have successfully attracted new cardholders by eliminating or waiving annual and other fees and by providing lengthy grace periods during which no finance charges accrue on outstanding balances.

In order to retain existing cardholders, and attract new customers, many other card issuers offer an extensive array of services and other enhancements as part of their credit card programs. AT&T offers most of its cardholders a 10% discount on AT&T long distance calling card rates. Other card issuers provide their cardholders with enhancements and services, such as extended warranties on goods purchased by credit card, merchandise discounts, discounts and rebates for frequent use of the card, frequent flier mileage for credit card usage, a variety of travel and car rental related insurance protections, buyer protection for stolen or damaged goods, 24-hour customer service,

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6 The Profitability of Credit Card Operations of Depository Institutions, An Annual Report by the Board of Governors of the Federal Reserve System, at 8 (September 1993).

emergency card replacement, instant credit line increases and convenient access to emergency cash. As a result of this intense competition among credit card issuers, cardholders today receive more value than ever from their bank credit card programs. Moreover, more cardholders are taking advantage of bank credit cards than ever before -- approximately 75% of all households in the United States have a credit card.

3. Consumers Enjoy a Flexible, Worldwide Payment Mechanism.

In addition, credit card programs provide cardholders benefits which simply cannot be provided by other types of credit, such as installment lending programs. Installment loans typically involve a single extension of credit to a consumer for a fixed amount which is repaid over a fixed period of time. The proceeds of an installment loan can be provided to the consumer only through limited means, such as by check or funds transfer, and once the loan is repaid, the consumer ordinarily must reapply to obtain additional credit.

Credit card programs, on the other hand, provide qualified consumers with a payment mechanism recognized by, and usable at, millions of merchants and financial institutions worldwide. The value provided to consumers by the worldwide credit card payment systems should not be underestimated. For example, a cardholder may travel throughout the country, and most parts of the world, and use a credit card to make a series of purchases of goods and services at different locations and in different currencies and then receive and pay a single bill on which each transaction is identified.

In addition, consumers can use credit cards to pay for important goods and services, such as home appliances and car repairs. This wide acceptance of credit cards is particularly useful in emergency situations where a consumer may not have another readily available means of payment. The credit card payment mechanism also is safe, since the federal TILA limits losses to the consumer from a lost or stolen credit card to $50. Increasingly, credit cards also provide consumers with quick and easy access to cash throughout the world, 24 hours a day, seven days a week, through banks and networks of automated teller machines. Moreover, credit cards are virtually indispensable for reserving and obtaining many services, such as hotel accommodations and car rentals, throughout the country and the world.

4. <u>Consumers Receive Grace Periods and Repayment Discretion</u>.

These credit card accounts also are provided to cardholders under flexible repayment features which are selected largely at the option of the cardholder. In most bankcard programs, the cardholder decides each month whether he or she will incur interest charges for obtaining the credit extended through a credit card.

At present, most bankcard plans charge interest only if the cardholder pays less than the full amount billed to the account during the billing period. Thus, the cardholder usually determines whether, and to what extent, he or she will pay interest for credit extended. Currently, between 35% and 40% of all cardholders pay off their entire balance when billed. Cardholders who pay off their entire balance when billed receive as many as 40 to 50 days of free credit from the date of purchase to the date the payment must be made, while paying no finance charges to the card issuer to offset the costs of establishing and maintaining their accounts and processing their transactions.

For example, if a cardholder makes a purchase on the 5th of the month and is billed on the 30th of the month, no interest charges will be accrued on the amount of the purchase for the 25-day period between the 5th and 30th under the terms of most credit card programs if the cardholder repays this amount when billed. In addition, most card issuers provide cardholders with an additional period of up to 25 days or more after the cardholder is billed to repay the full amount billed without interest. Thus, if such a cardholder pays the account balance in full before the expiration of this period, he or she will have received the benefit of an interest-free loan for the amount of the purchase for up to 50 days.

Experience demonstrates that the convenience and range of services provided through credit cards provide tremendous value to cardholders. In selecting credit card programs, cardholders consider many factors, including the type and quality of services provided by card issuers. Certain cardholders are attracted to programs offered by local card issuers, while other consumers are attracted by larger card issuers with extensive branch networks which provide other banking products and enable a cardholder to enter a bank branch to resolve a problem with his or her credit card account.

Still other cardholders are attracted to affinity card programs or measure the value of their credit card account in terms of the prestige of gold card programs or the level of enhancements provided by a particular card

issuer. The growth and success of programs which attempt to differentiate themselves by providing such services makes it abundantly clear that credit card interest rates are only one factor considered by consumers when selecting from competing credit card programs. Given the unparalled flexibility and the extensive consumer benefits, it is difficult to comprehend why Congress would consider encumbering this industry with a legislative proposal like H.R. 1842.

C. Costs of Providing Credit Card Services.

1. Credit Card Programs and Systems are Costly to Operate.

The costs of providing credit card services to consumers are quite high. Card issuers must price their products to obtain an adequate and fair return on an extremely large investment, which for VISA members alone has been estimated at $10 billion over time. At the same time, card issuers must cover operating expenses, credit losses and fraud losses, as well as the cost of funds. Operating expenses represent a substantial portion of the costs incurred to run the credit card systems, a much higher portion of overall costs than any other form of consumer or commercial credit. These expenses include the cost of maintaining and expanding the extensive telecommunication networks which are the cornerstones of the bank credit card systems. These networks are vital to merchants participating in bankcard systems who ordinarily must seek authorization from a card issuer in order to complete a credit card transaction. In most transactions, authorization is provided through electronic means. Although this advanced technology dramatically increases the speed and convenience of credit card transactions, while improving credit card system security, the computer systems and telecommunication infrastructures needed to operate such procedures are increasingly costly for the bankcard industry.

Operating expenses also include the enormous costs of maintaining systems which permit the electronic transmission of sales data from merchants, who normally submit their transaction records through local banks and processors, to card-issuing banks, which often are located in different regions of the country or even the world. In addition, card issuers incur substantial costs to establish and maintain data processing systems to accommodate the credit card billing and payments process. For every billing cycle, hundreds of millions of periodic statements must be prepared and mailed to cardholders. Under the TILA, these statements must specifically identify every transaction, and

reflect each payment, made by the cardholder during the billing cycle.

The TILA also requires card issuers to develop and maintain the capacity to respond promptly to cardholder inquiries concerning their credit card accounts and to resolve quickly disputes and questions that arise in connection with such accounts. A failure of a card issuer to do so can result in both forfeitures and penalties. Thus, card issuers must employ trained personnel who understand the legal requirements of the TILA and the credit card systems' rules, and can resolve disputes quickly to meet the deadlines for error resolution established under the TILA. In addition, card issuers must bear the significant expenses incurred to maintain systems which enable card issuers to satisfy the error resolution requirements of the TILA. These expenses include the cost of administering the process established by the bankcard systems to resolve cardholder disputes and errors, and to allocate among the members of the bankcard systems the costs associated with such errors and disputes.

As the credit card systems have expanded geographically, and the number of merchant categories which accept payments through credit cards has continued to grow, the cost of operating the credit card systems has increased. These operating expenses will continue to grow over time due to inflation and other changes in economic conditions. The additional requirements contemplated by H.R. 1842 will greatly increase these operating expenses, thereby significantly increasing the overall costs of offering and maintaining credit card accounts.

2. <u>Credit Card Lending is Riskier than Other Consumer Lending</u>.

The dramatic increase in consumer bankruptcies over the last decade also has drastically increased the cost of credit card operations. Losses from consumer bankruptcy filings have reached unprecedented levels and a significant portion of these losses are borne by financial institutions participating in the bankcard systems. VISA and MasterCard estimate that financial institutions participating in their two bank credit card systems alone lose more than $3.65 billion each year as a result of cardholder bankruptcy filings. Although card issuers are attempting to formulate new procedures to reduce credit risk without significantly reducing the availability of credit, it is anticipated that credit losses will continue to increase. Since 1980, the number of consumer bankruptcy filings has almost tripled.

Credit card fraud and counterfeiting losses also continue to impose significant costs on the credit card

industry. MasterCard and VISA, and their member financial institutions, have aggressively pursued and effectively addressed numerous fraud and counterfeiting schemes, but new schemes are created continuously. It is estimated that financial institutions participating in the VISA and MasterCard credit card systems now lose hundreds of millions of dollars annually as a result of telemarketing fraud alone.

3. Cost of Funds Reductions Have a Relatively Low Impact on Credit Card Pricing.

As previously noted, the increases in operating expenses, credit losses and fraud losses incurred by the credit card industry have not been offset by continued reductions in the cost of funds, since reductions in the cost of funds have a relatively modest impact on the overall costs of maintaining a bank credit card program. The costs of funding a bank credit card program, as a percentage of total lending costs, are low compared to other types of lending. Typically credit card funding costs represent from 25% to 50% of the total cost of operating the credit card program. This is in stark contrast to comparable cost of funds figures for other types of lending, which typically range from 70% to 80% of total lending costs. For example, the cost of funding a mortgage lending operation or commercial lending operation often is 75% or more of the overall cost of operating such a program. Thus, reductions in the cost of funds should be expected to have a more significant impact on mortgage rates, auto loan rates and other similar installment lending rates. Reductions in the cost of funds have been less beneficial to the credit card industry, however, and have not been enough to offset the growing operating expenses, credit losses and fraud losses. Moreover, as competition for cardholders continues to intensify, card issuers have lowered rates and other terms to attract and retain cardholders, which places further pressure on credit card profitability.

4. Credit Card Pricing Must Remain Flexible.

Given the nature of credit card programs, which permit cardholders to obtain, at their convenience, principally unsecured extensions of credit over an indefinite period of time, and given the ever-changing economic conditions which affect the cost of operating credit card programs, it is essential that card issuers continue to have the flexibility to price their programs efficiently based on market conditions, rather than statutory restrictions. Congress recognized this fact in 1988, and again in 1991, when it rejected credit card pricing restrictions in light of the significant detrimental

impact such restrictions have on consumers, card issuers, and the economy as a whole.

Restrictions that reduce pricing flexibility would have a chilling effect on innovation in the credit card industry. If card issuers are not free to price their products based on market conditions, many card issuers may forego introducing new services because of the risk that they will not be able to recover the costs of developing such services. Such restrictions also would threaten the continued existence of popular rebate and frequent flier programs and would more generally limit consumer choice by restricting the wide range of enhancement programs available in the marketplace today.

This pricing flexibility also is essential for the continued wide availability of credit card accounts. Today, credit card accounts are available to more people than ever before. **This is due, in large part, to the fact that card issuers generally are free to price their accounts based on the specific costs and risks associated with each particular credit card program, and based on individual cardholder risk profiles. Any statutory requirements that reduce this flexibility would limit the availability of credit cards to those who are most creditworthy.**

Banks offering credit card accounts with reduced annual percentage rates typically must maintain more stringent underwriting standards in order to reduce the risk of credit losses and to maintain profitability. Many consumers simply cannot qualify for credit card accounts with substantially reduced interest rates, since banks offering such programs must be even more selective in establishing credit card accounts.

For example, bankcard issuers located in Arkansas offer their credit card accounts at an interest rate of under 10% because an Arkansas usury law prohibits banks from charging customers more than 5% over the Federal Reserve's discount rate. Although the credit card accounts of these banks are widely publicized, it is relatively difficult for consumers to obtain an account from one of these banks because they can only provide credit cards to the most creditworthy consumers in order to maintain profitability given the relatively low rate Arkansas banks are permitted to charge on their accounts. **In fact, one recent study found that credit card issuers headquartered in Arkansas reject 80% to 90% of all credit card applications. Few if any lower- and moderate-income families are likely to be approved for credit card accounts under such circumstances.**

SPECIFIC OPERATIONAL AND OTHER PROBLEMS THAT WOULD BE CREATED BY H.R. 1842

The amendments to the TILA which are proposed by H.R. 1842 would increase the cost and reduce the availability of credit card accounts to consumers, would reduce the value and marketability of credit card portfolios, and would create substantial operational difficulties for card issuers. Moreover, H.R. 1842 would impose enormous new regulatory burdens on an industry which is already comprehensively regulated. The credit card industry is subject to a vast regulatory scheme which includes federal statutes such as the TILA, the Fair Credit Billing Act, the Fair Credit and Charge Card Disclosure Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, and dozens of state statutes and regulations. In view of the existing comprehensive regulation of the credit card industry, it is impossible to justify imposing additional regulatory burdens on card issuers such as those that would be established under H.R. 1842. The significant operational and other costs that would be imposed by provisions of H.R. 1842 would outweigh any benefits to consumers.[7]

Moreover, Congress has recognized the need to reduce regulatory burdens on financial institutions and is considering a number of regulatory relief proposals. Those Congressional proposals are intended to reduce precisely the types of excessive and unnecessary burdens that would be created by legislation such as H.R. 1842.

A. New Change in Terms Requirements.

1. Disclosure Requirements.

Sections 3(b) and 4(a) of H.R. 1842 would require a card issuer to provide three separate notices before changing certain credit card account terms. First, the bill would require that specified disclosures be made in a statutorily mandated tabular format (the so-called "Schumer Box" format), presently required under the TILA for certain credit card applications, on at least one periodic statement before a change in terms becomes effective. In addition to the notice on the periodic statement itself, a separate disclosure notice also must be included in the envelope containing that periodic statement, and a third notice must be presented on the outside of the envelope which includes the periodic statement.

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7 David S. Evans and Richard L. Schmalensee, The Economics of the Payment Card Industry at 110 (1993).

More specifically, H.R. 1842 provides that any change made by a card issuer in the "principal terms" or "ancillary fees" required to be disclosed pursuant to the TILA credit card application disclosure requirements cannot take effect unless the card issuer sends to its cardholders, prior to the effective date of the change, one or more periodic statements which disclose, in a tabular format, all of the principal terms and ancillary fees that will apply to that credit card account after the date of the change. The principal terms required to be included under the additional periodic statement disclosure requirements are: (1) the annual percentage rate or rates used to compute the finance charge on an outstanding balance for purchases; (2) any annual fee or other periodic fee that may be imposed for the availability of the credit card; (3) any minimum finance charge; (4) any transaction charge imposed for purchases; (5) the grace period for purchases; and (6) the balance computation method used to determine the outstanding balance for purchases. The ancillary fees required to be disclosed are: (1) any cash advance fee; (2) any fee imposed for a late payment; and (3) any fee imposed for extensions of credit that exceed the credit limit for the account. All of these disclosures would have to be disclosed in the tabular "Schumer Box" format in <u>three</u> separate disclosures: (1) <u>on</u> at least one periodic statement; (2) <u>with</u> that same periodic statement; and (3) on the <u>envelope</u> <u>containing</u> that periodic statement, even if only one of the terms actually is changed by the card issuer.

It is also important to note that this new periodic statement change in terms requirement is completely unnecessary given the existing change in terms notice requirements already imposed by section 226.9(c) of Regulation Z, promulgated under the TILA by the Federal Reserve Board. Under this existing regulation, a card issuer <u>already</u> is required to provide all of its cardholders with written notice before the card issuer can change important credit card account terms. As a result, cardholders already receive adequate notice of, and information concerning, changes to their credit card accounts.

In addition to being unnecessary, the unduly complicated periodic statement change in terms disclosure requirements that would be imposed by H.R. 1842 would create substantial additional costs for card issuers. The bill requires that periodic statements provided to cardholders prior to the effective date of a change in terms must "contain" the contemplated table of principal terms and ancillary fees. The periodic statement forms currently used by card issuers are designed to provide the extensive information already required to be disclosed under the TILA and the laws of various states. If there is any suggestion

that new disclosures must be included _on_ the periodic statement itself, card issuers would be required to incur substantial expense to redesign these already overcrowded statements in an attempt to accommodate the new tabular format disclosures required by H.R. 1842. In addition to the expense, the inclusion of such disclosures would detract from all of the other information already required to be disclosed on such periodic statements by existing laws.

These new disclosure requirements also would require card issuers to make changes to the computer systems used to generate these periodic statements. Card issuers already have invested hundreds of millions of dollars in developing those systems and any significant changes to the systems would be quite costly. The only alternative to making such changes to accommodate the new disclosure requirements would be to print special periodic statements each time a change in terms is made that would trigger the periodic statement disclosure requirements of H.R. 1842. This alternative compliance procedure also would be prohibitively expensive and still would require systems changes to accommodate the modified forms.

Even if these provisions are interpreted to provide that the information must be mailed _with_, rather than _on_, the periodic statement, the requirements still would necessitate that card issuers modify their processing systems to provide periodic statements to cardholders who otherwise would not receive such statements. In this regard, under the existing TILA, a card issuer is not required to provide a periodic statement to a cardholder for a billing cycle if the cardholder's account has a debit or credit balance of less than $1.00 and a finance charge has not been imposed for that cycle. This is in recognition of the fact that it is costly and wasteful to require card issuers to provide disclosures to consumers who are not using their accounts. If the requirements of H.R. 1842 were adopted, card issuers would need to modify the procedures and systems to generate periodic statements even for inactive accounts, during at least one billing cycle prior to the effective date of a change in terms. **The costs of complying with this requirement simply cannot be justified, particularly given the fact that card issuers must already notify cardholders of such changes under the _existing_ change in terms disclosure requirements of Regulation Z.**

The above problems would be compounded by the requirement in H.R. 1842 that would mandate that any increase in an annual percentage rate applicable to a credit card account, or any other adverse change in the principal terms or ancillary fees applicable to the account, may not take effect until 30 days after the date the cardholder

"receives" a separate notice of that rate increase or term change.

This provision raises a number of additional serious issues. For example, a card issuer simply will not know, as a practical matter, the date on which a particular cardholder receives the notice of the change unless the card issuer uses a special delivery method, such as certified mail. Such delivery methods are prohibitively expensive. Moreover, by establishing the wasteful and duplicative requirement that separate change in terms disclosures be provided with the periodic statement as well as on the periodic statement, the bill would dramatically increase the cost to card issuers of implementing basic changes in account terms. In addition to increasing costs, such duplicative disclosures, included in the same envelope, will only serve to create confusion for cardholders.

The costs created by these duplicative change in terms disclosure requirements would only be exacerbated by the third change in terms disclosure requirement set forth in the bill which would mandate that card issuers use special envelopes for transmitting the required disclosures. The use of such special envelopes would be prohibitively expensive for all card issuers, but particularly for small and medium size issuers who must rely on third-party processors to produce the periodic statements required under existing law. These costs simply cannot be justified, particularly in view of the fact that cardholders already receive adequate change in terms disclosures under existing law.

2. Right to Pay Off on Existing Terms After Change.

H.R. 1842 also provides that a cardholder who receives a change in terms notice may notify the card issuer that the cardholder is "rescinding" use of the account and will not request additional extensions of credit. If the cardholder does so, he or she may repay the outstanding balance of the account under the terms of the account in effect prior to the change.

Many bankcard issuers already have established their own programs for permitting cardholders to pay off accounts on existing terms when price changes are contemplated. The reason that card issuers are able to make these benefits widely available to consumers is that, under current law, card issuers have the flexibility to structure the programs in a manner that is consistent with their existing operational systems for servicing accounts and which complies with the requirements of applicable law. Many card issuers currently are subject to change in terms requirements under state law, in addition to those under the

existing TILA. These card issuers have invested significant amounts to establish systems and programs that comply with existing federal and state requirements. Under H.R. 1842, these card issuers would be required to adopt costly new procedures and systems changes to restructure their programs to comply with the new statutory change in terms requirements that would be mandated by the bill. Consequently, H.R. 1842 as presently drafted would have the greatest adverse impact on those card issuers that already permit cardholders to repay their accounts on existing terms, including the many card issuers who have voluntarily permitted their cardholders to do so.

Whether or not card issuers currently permit cardholders to repay on existing terms, all card issuers would be required to establish new programs under H.R. 1842 for billing and payments processing for cardholders who elect to reject the new terms offered by the card issuer. Establishing and maintaining these new programs would be expensive and the costs ultimately would be reflected in increased costs of credit. Although most operationally sophisticated card issuers have the capacity to accommodate such multiple billing programs, it would be much more difficult for small and medium size card issuers to do so.

This provision of H.R. 1842 also is likely to decrease the value and marketability of credit card portfolios by reducing the flexibility card issuers have to make even minor changes in the terms of credit card accounts they purchase from another card issuer to make the terms of the purchased accounts consistent with the terms of their existing accounts, so that all of the accounts can be maintained and processed in a similar fashion. This would be particularly unfortunate for economically troubled card issuers, since credit card portfolios currently are among the most marketable assets of financially distressed financial institutions, and of the Federal Deposit Insurance Corporation and the Resolution Trust Corporation once a troubled financial institution has failed.

3. <u>Federal Preemption of State Change in Terms Requirements</u>.

The operational burdens and economic costs of the change in terms provision of H.R. 1842 would be compounded if card issuers are required to comply with change in terms requirements under both an expanded federal law and various state laws. Modifications caused by differing state law requirements cause confusion for consumers and card issuers alike, and increase the costs of operating credit card programs. Accordingly, if any additional federal change in terms requirements are considered similar to those in H.R. 1842, it is important that individual states not be

allowed to vary the content, circumstances or procedures mandated in those federal requirements. Thus, complete federal preemption with respect to any such state change in terms requirements is essential. States must not be permitted to vary the requirements, even if a particular state legislature or court believes that different or additional requirements might somehow be helpful to consumers. In addition, given the extensive systems changes and procedural changes that would be required to implement new change in terms requirements, like those contained in H.R. 1842, any new requirements should only apply prospectively to changes made at least twelve months after the enactment of such legislation.

B. Additional Credit Card Disclosure Requirements.

In addition to imposing new change in terms disclosure requirements on card issuers, H.R. 1842 would establish several other new disclosure requirements which would further increase the cost of operating credit card programs and ultimately would increase the cost of credit for consumers.

1. Periodic Statement Disclosures.

Under section 3(a) of H.R. 1842, a card issuer would be required to disclose on every periodic statement furnished to cardholders, the total of all payments and the total finance charges paid by the cardholder to the card issuer during the current year. In addition, the card issuer would be required to include on each periodic statement the date by which the cardholder would finish repaying the current outstanding balance (together with all future finance charges on that balance), if the cardholder makes only the minimum payment required to be made each month under the plan.

This provision of H.R. 1842 would require card issuers to incur substantial costs to implement the systems changes necessary to aggregate the total amount paid and the finance charges paid by each cardholder, store that information throughout the year, and include that information in every single periodic statement sent to that cardholder during the year. The bill also would require card issuers to develop costly programs to calculate and disclose the mandated information.

Moreover, under the bill, card issuers would be required to redesign their periodic statement forms to accommodate the new disclosures in the format specified. The costs of redesigning and reprinting such forms would be substantial. Just as importantly, however, by requiring card issuers to add even more disclosures to forms which

already are crammed with the extensive disclosures required under existing federal and state law, the bill would reduce the utility and clarity of the periodic statement disclosures. **Finally, since only a small percentage of cardholders pay only their minimum payment each month, this very costly requirement would result in information that is at best irrelevant, and likely confusing, to the majority of cardholders.**

2. Annual Disclosures.

Under section 8 of H.R. 1842, the first three periodic statements sent to a cardholder each year would be required to include a separate statement disclosing, in tabular format, the total amount paid in the preceding year by the cardholder as finance charges and the total amount paid for certain specified other fees and charges. Once again, card issuers would be required to incur substantial costs to design systems to identify and aggregate the specified account information for every cardholder, store that information throughout the year, and furnish that information to each cardholder on a separate document with three separate monthly statements at the beginning of every year.

With over 230 million credit card accounts in the nation today, the cost incurred by the industry simply to print such disclosures would be staggering. The legislation would further exacerbate the costs, however, by requiring that these new separate disclosures be furnished to each cardholder, not once, but three times. Moreover, the legislation may actually require a card issuer to furnish the annual disclosures to cardholders even if their accounts were entirely inactive in the preceding year or if the cardholder has stopped making payments on his or her account altogether. Providing such disclosures to inactive or defaulted account holders is quite costly and provides no benefit to consumers.

3. Envelope Disclosures.

Section 3(c) of H.R. 1842 also would require that any envelope containing a credit card application or solicitation subject to the existing TILA credit card application disclosure requirements, have printed on the outside of that envelope, in the Schumer Box tabular format, "the information required to be included in such application, solicitation or periodic statement." This would require separate and distinct Schumer Box disclosures on envelopes for every credit card program offered by a card issuer, even if the programs differ only as to a single term, and even though the same disclosures are already required to be included inside that very envelope.

As a practical matter, it may be impossible for many card issuers to include on an envelope, the tabular format disclosures applicable to their credit card programs. For example, a single card issuer can maintain dozens if not hundreds of separate credit card programs. In multistate programs (especially those offered by retailers), annual percentage rates, annual fees and other terms can vary between states. Each of the many affinity card programs (most of which involve nonprofit organizations) offered by a card issuer likewise typically would require separate envelopes. A card issuer simply would not be able to print all of its terms for each of these accounts, in tabular format, on the outside of its envelopes. Card issuers would be required to incur the expense and operational difficulties of using separate envelopes for each state in which they issue credit cards and for each different type of account they offer. The cost and waste created by such envelope disclosures would be multiplied in the case of third party credit card processors that service separate credit card programs for hundreds of small issuers and would be required to print, maintain and update thousands of different envelopes to accommodate the proposed Schumer Box disclosures.

All of this cost and waste is to provide on the outside of these envelopes the very same information that is already required to be clearly disclosed on the <u>inside</u> of the very same envelopes. With proposals like this, it is no wonder that Congress must spend so much time talking about regulatory relief.

4. <u>New Advertising Disclosures</u>.

Section 3(d) of H.R. 1842 also would establish new disclosure requirements for advertising of credit card accounts. The bill provides that any advertisement of credit card accounts must include a disclosure of any minimum, fixed, transaction, activity or similar charge that could be imposed in connection with the account, and any periodic rates that may be used to compute the finance charge applicable to such accounts (expressed as annual percentage rates). In addition, under H.R. 1842 such advertisements also must disclose, in tabular format, the six principal terms applicable to the account and any cash advance fee that might be imposed, as well as any other information required to be disclosed by the Federal Reserve Board. **Thus, under H.R. 1842 <u>every</u> advertisement for credit card accounts, however general it might otherwise be, would be required to include disclosures for ten or more specific credit terms.**

With respect to television advertising, the bill would require that the six principal terms and any cash

advance fees be disclosed in tabular format during the television broadcast itself. The bill also provides that any radio advertisement must include a verbal disclosure of any minimum or fixed charge which could be imposed, any periodic rates that may be used to compute the finance charge (expressed as annual percentage rates), any annual fee or other periodic or membership fee imposed for the issuance or availability of the credit card, any minimum finance charge, any transaction charge imposed for purchase transactions, any cash advance fee imposed, as well as grace period disclosures. Both of these proposed requirements are incomprehensible given the expense and limitations of the media.

Usually, newspaper, television, radio and other media advertising are designed to make a card issuer's credit card program known generally. Such advertising is less immediate in its message than are "applications" or "solicitations," which already are subject to the credit card application disclosure requirements of the TILA. In addition, a card issuer currently can publish other printed advertising materials about its credit card program without including an application form or a solicitation response form. Such an advertisement can, for example, take the form of a brochure which discusses an entire range of available consumer products and services, and invites the consumer to inquire about these services, but does not contain an application form. If the card issuer elects to include an application, it already is subject to extensive disclosure requirements under existing law. If it does not, the consumer will receive these disclosures when he or she later obtains an application form for the credit card account.

Moreover, requiring such extensive specific disclosures as part of television or radio advertising would greatly increase the cost and reduce the effectiveness of a typical 30-second commercial. For example, verbal disclosure of the principal terms of a credit card account during a 30-second radio commercial would likely consume all of the commercial, leaving no time for advertising at all. **As a result, the imposition of such requirements in connection with television or radio advertising would likely end such advertising entirely; a result that can only reduce competition in the credit card market.**

In short, the advertising disclosure requirements imposed by H.R. 1842 would create operational difficulties and costs that would far outweigh any possible value the added information could provide to consumers in addition to that already required under the existing TILA advertising requirements. **Moreover, this legislation could actually decrease competition by discouraging advertising. There is simply no justification for subjecting credit card**

advertisements to additional disclosure requirements, let alone those imposed by H.R. 1842. Such detailed disclosure requirements should apply only to applications or solicitations sent to consumers by card issuers, and this is already mandated under the existing TILA.

5. Schumer Box Disclosure of Rate for Cash Advances.

Section 3(e) of H.R. 1842 would expand the Schumer Box disclosures required for credit card applications and solicitations to include the annual percentage rate for cash advances, if that cash advance rate is different from the rate for purchases. This disclosure requirement is inconsistent with the principal purpose of the existing Schumer Box disclosures required by the current TILA. The Schumer Box disclosures are intended to provide to consumers early disclosure of "key" credit card terms that a consumer should focus on for purposes of comparison shopping among credit card accounts and selecting the account best suited to the consumer.

For the vast majority of cardholders, cash advances represent an insignificant percentage of their credit card transactions and, thus, the cash advance rate simply is not a "key" term. **Disclosing cash advance rates in equal prominence with purchase rates can only distract consumers from the key disclosures and may actually result in consumers erroneously selecting accounts on the basis of a cash advance rate.** For example, consumers may select an account based on a lower cash advance rate without recognizing that the cash advance feature is seldom used and that the purchase rate is the key rate for rate sensitive consumers. In order to maximize the utility of the existing application disclosure requirements they should continue to be limited to key credit card terms and, thus, should not include cash advance rate disclosures.

6. Additional Schumer Box Grace Period Disclosure.

Under section 3(f) of the bill, card issuers also would be required to include in the Schumer Box, in bold print, the terms and conditions under which a grace period offered by a card issuer will be "forfeited." **This additional disclosure is unnecessary since under the existing TILA the Schumer Box already must state the date by which the cardholder must, or the number of days a cardholder has to, repay for the grace period to apply.** Including an additional detailed grace period disclosure would only distract consumers from the key disclosures already included in the Schumer Box. This problem would be compounded by the fact that this proposed grace period disclosure must be in "bold" print while other disclosures need only be "clear and conspicuous." **Also, requiring such**

detailed disclosures is contrary to the fundamental purpose of the existing application disclosure requirements -- to concisely provide to consumers key information to enable them to comparison shop among credit card programs.

C. Limitation on Imposition of Finance Charges.

Section 5 of H.R. 1842 would prohibit a card issuer from imposing a finance charge on a credit card transaction until the date the transaction is physically posted to the cardholder's account. This requirement would be extremely costly for many card issuers. Card issuers would be required to change their systems to calculate finance charges from the posting date, rather than from the transaction date -- that is, the date on which the cardholder actually uses his or her credit card to make a purchase and thereby obtain credit on his or her account. In other words, under H.R. 1842, card issuers would be required to forego compensation for the period between the transaction date on which the cardholder receives the benefit of the credit extension and the date the transaction is posted to the cardholder's account. In order to offset the lost revenues caused by this provision of H.R. 1842, affected card issuers may have to raise other fees or charges. **Thus, this provision would create significant operational problems and increase credit costs, without providing any corresponding benefit to consumers.**

D. Restrictions on Use and Disclosure of Cardholder Information.

Section 6 of H.R. 1842 would prohibit card issuers from using or disclosing credit card information for marketing purposes, unless certain disclosures are provided to cardholders and those cardholders are given an opportunity to prohibit the use and disclosure in the future. The provision apparently is intended to restrict card issuers from selling information concerning credit card accounts to third parties. However, the provision is far too broad to appropriately address this issue. For example, the bill as drafted would restrict card issuers from using their own information to determine whether to offer a customer a credit line increase or another credit card product, such as a gold card, even if the card issuer never provides any information to any third party.

The bill also would restrict the ability of retail establishments to use their own account information to provide their own credit card customers with such traditional features as holiday catalogues. Moreover, because the amendment is not limited to traditional credit cards, it also could cover deposit accounts if such accounts

have overdraft protection and could be accessed by an ATM or check guarantee card.

The bill also would require such card issuers to provide new initial and annual disclosures to cardholders, even if the card issuer never discloses any customer information to third parties. In addition, card issuers would be required to make such disclosures on separate forms and would not be provided with the flexibility to incorporate them into one of the many disclosure forms already required under federal and state law. Under the bill, card issuers also would be required to incur the substantial costs of providing cardholders with a postage-paid, self-addressed form, or establishing a toll-free telephone number for cardholder use.

E. Study on Competition.

Under section 7 of H.R. 1842, the Comptroller General, in consultation with the Federal Reserve, would be directed to study competition in the credit card industry. Quite simply, such a study is entirely unnecessary. As noted above, over the last several years, competition in the credit card industry has been the subject of extensive study by federal agencies, independent economists, and industry groups. Study after study has concluded that the credit card industry is extremely competitive. Indeed, the Federal Reserve Board's most recent report to Congress on the subject describes the competition in the industry as "intense, with [approximately 6,000] firms offering [bankcards] to consumers," and notes that card issuers, including almost all of the largest issuers have reduced their rates.[8] **In view of the extensive body of learning on this subject, another federal government study simply cannot be justified. Moreover, the GAO staff already is in the process of completing a report on credit card competition in response to a request from Representative Schumer. To avoid further confusion and waste of government resources, Congress should, at a very minimum, review the findings of the GAO study that is already underway before attempting to decide whether an additional study is warranted.**

In any event, the issues identified in H.R. 1842 for the study are far too narrow to appropriately assess the scope or intensity of competition in the credit card industry. In the unlikely event that yet another GAO study is found to be necessary after reviewing the results of the

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8 The Profitability of Credit Card Operations of Depository Institutions, An Annual Report by the Board of Governors of the Federal Reserve System, at 8 (September 1993).

ongoing GAO study, that future study should analyze all aspects of competition in the credit card market. A narrow listing of issues "to be studied" such as that included in H.R. 1842 is particularly inappropriate and will only raise more questions than it answers.

F. Requirement to Furnish Cardholder Agreement Upon Request.

Section 9 of H.R. 1842 would require that, upon request, a card issuer furnish a copy of the agreement governing its credit card plan. This requirement is unnecessary since card issuers already are required under the existing TILA to disclose to cardholders key credit card account terms before the first transaction under the account. In addition, card issuers typically furnish copies of their cardholder agreements to prospective cardholders on request. Moreover, the provision in H.R. 1842 would create significant uncertainty regarding the circumstances under which a copy of the agreement must be furnished. For example, the provision does not specify the manner in which a copy of the agreement may be requested (e.g., in writing, by telephone or by other means), whether the card issuer may specify a particular location to which requests must be directed, or how often someone may request such a copy. The bill does not even require that the requestor be an existing or prospective cardholder. **There is simply no justification for requiring card issuers (and ultimately consumers) to bear the expense of producing and making available to the general public cardholder agreements given the existing initial disclosure requirements already contained in the TILA.**

G. Federal Reserve Toll-Free Telephone Number for Rate Information.

Section 3(g) of H.R. 1842 would require the Federal Reserve Board to operate and publicize a toll-free telephone line that consumers may call for free information regarding low-rate credit cards. Information on low-rate credit cards already is made widely available to consumers through print and broadcast advertising, direct mail solicitations and a variety of other publicly available materials. If such a Federal Reserve toll-free telephone number is to be established, however, it is important that any such Federal Reserve information service accurately inform consumers of the full range and variety of options available from each card issuer covered by the service, rather than narrowly focusing on a particular type of account or subset of terms offered by the card issuer.

CONCLUSION

H.R. 1842 is entirely unnecessary. Its intended purpose -- to increase competition through increased disclosure -- already has been achieved through the existing requirements of federal and state law and an unconcentrated market comprised of thousands of aggressive competitors. Indeed, the credit card industry is more competitive today than ever before and is among the most competitive industries in the entire country. The competition in the credit card industry has resulted in an increase in the availability of reduced rate and fee credit card programs, and an increase in the level and quality of credit card services and enhancements provided to cardholders. At the same time, operating costs, credit losses and fraud losses have increased substantially and have not been offset by reductions in the cost of funds. Such costs, combined with intensive competition driving rates down, continue to put pressure on credit card profitability. We believe that card issuers must continue to have the flexibility to price their products based on market conditions if bankcard systems are to continue to develop and if credit card accounts are to continue to be widely available to consumers of all income levels.

The operational and other costs that would be imposed on card issuers by H.R. 1842 can only serve to increase the cost of credit to consumers and will result in decreased credit availability, particularly for lower- and moderate-income families. Such results simply cannot be justified in view of the extensive regulatory scheme already in place which currently ensures that consumers receive comprehensive disclosure concerning credit card accounts. Legislation like H.R. 1842 also must be examined in the broader context of Congressional and industry concerns over the far-reaching negative impact of the existing level of regulatory burden. However well intentioned, H.R. 1842 is the epitome of legislation that would impose operational and economic burdens that would far outweigh any conceivable benefits that could be gained by its enactment.

Once again, we appreciate the opportunity to appear before this Subcommittee to present our views.

BANKCARD HOLDERS OF AMERICA
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A non-profit organization helping bankcard holders become informed consumers.

TESTIMONY BEFORE THE HOUSE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

BANKCARD HOLDERS OF AMERICA
GERRI DETWEILER, EXECUTIVE DIRECTOR

FEBRUARY 10, 1994

Thank you for the opportunity to appear before you today to share our views on H.R. 2175 and H.R. 1842.

Bankcard Holders of America is a national, non-profit organization focused exclusively on consumer credit education and advocacy. Since 1980, we have been helping people get out of debt, save money on credit, and solve their credit problems. We are supported by hundreds of thousands of consumers nationwide.

We are also presenting our testimony today on behalf of the U.S. Public Interest Research Group (U.S. PIRG), the national lobbying office for state public interest research groups, which are consumer and environmental advocacy groups with over one million members around the country. We are also joined by Consumer Federation of America, a consumer advocacy group representing 240 member organizations whose members total more than 50 million consumers.

I would first like to address H.R. 2175, the Credit Card Reform Act of 1993.

This is not the first time that Bankcard Holders of America has addressed Congress on the issue of credit card surcharges. In 1984, we were part of a coalition, called Consumers Against Penalty Surcharges, which included state consumer protection agencies, consumer groups and industry representatives. That coalition was trying to persuade Congress to reinstate the federal ban against surcharges, which had been extended twice, but expired ten years ago in February, 1984.

Bankcard Holders of America has been -- and still is -- opposed to credit card surcharges for several reasons:

Most importantly, they represent a hidden cost of credit. Credit card companies are adding so many "back-end" charges on credit cards that many consumers don't know what they are really paying for the money they borrow on plastic. Consumers are supposed to be able to shop for credit based on the Annual Percentage Rate, but if

surcharges are allowed, many consumers would have no idea how that affects the real cost of the money they are borrowing.

We are also concerned that surcharges encourage "bait and switch" tactics. If businesses were allowed to impose surcharges, it would likely create situations where consumers would shop around for the best price on an item but then be assessed a surcharge that would make the purchase significantly more expensive.

We realize that this bill specifically allows government agencies, not businesses, to impose surcharges, but we believe that broadly allowing government agencies to impose surcharges creates a lot of problems.

BANKCARD HOLDERS OF AMERICA OPPOSES H.R. 2175 BECAUSE...

- **It does not protect consumers against *usurious* surcharges.** The bill allows government agencies to charge a surcharge of any amount. This could result in abuse by government agencies that see this as a way to "cash in" on credit card customers. Virginia's Department of Motor Vehicles, for example, charged a 3.5% surcharge, which is much higher than the average merchant discount rate of 1.9%,[1] and the lowest rate of 1% for certain types of businesses.

- **H.R. 2175 will most hurt consumers who can least afford it.** A consumer who has plenty of money to pay her tax bill or another government charge can choose whether it is worth the surcharge to pay by credit card. It's the consumer who *doesn't* have the money to pay and is forced to use her credit card who will really be burdened by this additional cost. A 3.5% surcharge on a $500 bill, for example, comes to $17.50. That's in addition to the interest the consumer will pay to the credit card company, if she can't pay off the bill immediately.

- **It sets a double standard.** Congress found it necessary nearly two decades ago to protect consumers against surcharges when it enacted a federal ban on surcharges. Passing a federal law prohibiting credit card companies from protecting consumers against surcharges appears to be an about-face, to say the least.

- **It could lead to surcharges by all types of business.** It is not a stretch to think that businesses will next be clamoring for Congressional permission to assess surcharges. After all, if it's important enough for the government, isn't it important enough for America's businesses?

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[1] The Future of the Credit Card Industry, report by Bernstein Research, January 1993.

- **It is very likely to cause consumer confusion.** We at BHA have widely publicized the fact that surcharges are prohibited by Visa and Mastercard and have received letters from consumers who are then confused and angry when they find their state or county government is imposing them.

Next, I would like to comment on H.R. 1842, The Credit and Charge Card Disclosure and Interest Rate Amendments Act of 1993.

CREDIT CARD INTEREST RATES

Credit card interest rates, on average, have been declining over the past two years, leading many people to believe that the "problem" of sticky credit card rates is over. While credit card rates have declined over the past year, millions of people are still paying very high interest rates – as high as 20 to 24% – for the money they borrow on credit cards. What's worse, however, is that millions of people who think they have a decent rate on their credit cards may be paying much more than they realize.

I am sure you will hear today from industry representatives who will tell you the credit card market is very competitive– that there are thousands of issuers competing with each other and that consumers have many choices. I do not dispute the fact that there are numerous choices.

You will also hear from the industry today that rates on credit cards have been declining, while costs have been rising, thus putting enormous pressures on credit card profitability. The current average interest rate on bankcards (Visa, MasterCard, and Discover) is 16.5% or 16.75%, depending on the source. Again, I do not dispute the fact that rates have been coming down. Talk of low rates, however, can be very deceptive.

Attached you will find a chart listing average credit card rates for the past fourteen years. We used the discount rate to illustrate what has been going on with interest rates in the economy versus bankcard rates. (Keep in mind that this chart does not include retail credit cards which, in almost all cases, have interest rates of 18% to 24%.)

Looking at the chart, you can see that while interest rates on credit cards have reached a so-called "historical low," the spread between credit card rates and other interest rates in the economy is higher than it was throughout the 1980's. We are not suggesting that credit card rates should mirror other interest rates, but they should *reflect* what has been happening with other interest rates. As always, credit card rates are slow to react to what is happening with other rates.

Other factors have contributed to the continuing profitability of credit cards:

- Lower delinquencies: forecasted at 3.9% of outstandings through 1994,

versus 4.4% in 1992.[2]

- Fewer personal bankruptcies. Filings as of last June 20, 1993 were down 5% from the year before.[3]

- Decline in bad debt. Charge-offs are down from 5.2% in 1992 to 4.3% of outstandings in 1993.[4]

A growing percentage of all bankcard programs offer variable rate cards (which means the interest rates are tied to a rate in the economy) and the industry is increasingly moving in that direction. That means that cards with a hefty spread built in -- such as those with APR's of 15% to 16% right now -- are going to continue offering issuers attractive finance charge revenue should interest rates rise.

To summarize, the credit card industry is still enjoying healthy profits and is likely to continue to enjoy them in the future.

UNFAIR INTEREST RATE HIKES

Congressman Schumer's bill also provides some important protections against what we believe are unfair practices. Probably the most important provision in the bill, in our opinion, is protecting consumers against arbitrary changes in the interest rate.

Here's an example of a card offer touting a fixed interest rate.[5] This offer for a credit card touts in big letters on the envelope a fixed rate of 6.9%. If you asked a group of people what that term "fixed rate" means, most would likely say that the rate will stay the same until the loan is paid off.

But under current federal regulations, that is wrong. Currently, the definition of "fixed" in the credit card industry means "fixed until the credit card issuer changes its mind." If an issuer wants to raise the rate on your "fixed" rate credit card, it can do so at any time. It can raise the rate to whatever level is legal in the state in which its credit card operations are located -- and it only has to give the consumer fifteen days advance written notice. Worse yet, the issuer can apply the new higher rate to the your outstanding balance -- the money you've already borrowed. The change-in-terms notice, by the way, can be buried in fine print in anything sent to the cardholder.

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[2]. "Same Tune, Cheerier Notes," *Credit Card Management*, December 1993, p.22.

[3]. Administrative Offices of the U.S. Bankruptcy Courts.

[4]. "Same Tune...," op. cit., page 22.

[5]. Credit card solicitation, attached.

What choice does the consumer have if the issuer raises her rate? None. She will be forced to go out and get another loan to pay off this loan (if she can) and pay the higher rate in the meantime.

Many consumers are confused about what a fixed rate means. One survey, for example, showed 72% of consumers said they had a fixed-rate credit card, when, in fact, the figure is estimated to be closer to 50%.[6]

You will likely hear from the industry that it will simply be too expensive and burdensome to adhere to Congressman Schumer's proposal to give consumers the option to "opt-out" of a rate increase and pay off the loan at the original terms. We simply do not believe that is true for two reasons:

First, there are a number of issuers that are subject to similar regulation already. Delaware is a haven for credit card issuers, in part because state laws are favorable to the credit card industry. The state of Delaware, however, currently has a law providing protection, similar to that found in Congressman Schumer's bill, for anyone whose credit card is issued out of Delaware.[7]

Secondly, issuers don't have to offer a fixed rate. Thousands of issuers offer variable rate cards. Since variable rate cards are not subject to this provision unless the index is changed, it's an easy and inexpensive alternative.

Finally, we think this measure only makes common sense. If a consumer and a credit card issuer agree to a loan under specific terms, we believe the issuer should honor those terms. If the credit card issuer wants to change that agreement all of a sudden, the consumer should at least be given reasonable notice and an opportunity to pay back the loan at the terms agreed upon.

There are a number of other issues in Schumer's bill that we think are very important and I would like to touch upon them briefly.

DISCLOSURE OF THE TIME AND COST TO PAY OFF CREDIT CARDS

Credit card issuers have been lowering the minimum payments on credit cards to such low levels that consumers may find their credit card bill can take as long to pay off as

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[6]. Synergistics Research Corp., as quoted in *Credit Card News*, October 15, 1993, p. 3.

[7]. Delaware's law requires the issuer to notify the consumer of the pending rate increase. If the consumer does not expressly agree to the increase, and stops using the card, she will be permitted to pay the existing balance at the "old" rate and terms.

their 30-year mortgage. In many cases, issuers tout lower minimum payments as a benefit of the card.

Attached you will find a copy of an ad promoting lower monthly payments. Montgomery Ward has lowered the minimum monthly payment on its credit card nationwide. It is advertising this change as a *benefit* to consumers because it allows them to spend more (i.e. get deeper in debt) and pay the same low minimum payment. The ad states:

> **The same payment buys you more.** Under the 1/30th terms, a $20 monthly payment lets you buy an item costing $600. Now that same payment lets you buy $800 worth of Montgomery Ward merchandise. That's an extra $200 with no more to pay each month.

What the ad doesn't tell you is that if you buy $800 worth of merchandise and pay it off at the new, low monthly payment (at Ward's interest rate of 21.6% in many states), it will take **7 years to pay off the balance, and you'll pay $647 in interest charges alone!**

According to one industry study, some 46% of consumers sometimes or always just make the minimum payments on their credit cards. It's true that consumers have a choice – many can afford to pay more than the minimum payment. But it's also true that the large majority of cardholders have no idea how long it will take them to pay off their credit cards, if they just pay the minimum.[8] Even if they wanted to figure it out, most people would need a computer program to run it for them. We do believe that providing this information on the statement will help cardholders better manage their debt.

Congressman Schumer has proposed that, along with the minimum payment, lenders be required to tell consumers the total cost of their credit card loan, and we couldn't agree more strongly that this information should be provided in a straightforward disclosure on the statement.

OTHER COSTS

For the record, we are submitting a copy of BHA's report, "Credit Cards: What You Don't Know Can Cost You." In our research, we found that as banks are feeling the pressure of lower interest rates, they are looking for ways to recoup that lost revenue from consumers.

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[8]. For example, if you have an average balance of $1,000 on a credit card with an interest rate of 16.5%, and a minimum payment of 2.5%, it will take you 8 years and 8 months years to pay it off and cost $766 in interest. If you have a balance of $5000 at that same interest rate, it will take 20 years and six months to pay off only making minimum payments, and will cost $5,655 in interest charges.

A good example of that is that most banks used to charge interest from the date of posting – the date they actually lend the money, but instead most have moved to backdating interest from the date of purchase. Many large issuers have changed from charging interest from the date of posting to charging interest from the date of purchase.

Back-end fees are also on the rise. Many banks have started relying on nuisance fees, such as late fees and over-the-limit fees, as a revenue stream, rather than just as a way to recoup the additional cost of handling these accounts. Citibank, for example, recently waived the annual fees on 7.1 million accounts. It is reported to be planning to recoup part of that $160 million loss in revenue, in part through $64 million more in penalty fees, and $20 million more in interest by lowering minimum payments.[9] Nationsbank reports that 30% of its revenue comes from fees and it is expected to rise to 50%.[10]

Another problem that Congressman Schumer's bill addresses is one we encountered in trying to do research for our report. We found that most issuers flatly refuse to send a cardholder agreement to a consumer until after she actually applies for and gets the card. Since the cardholder agreement is the contract, and contains a significant amount of information that is not included in solicitations or advertisements, this means that consumers are forced into signing a contract for a loan before they can see all the terms of the contract.

There is actual harm in not providing a cardholder agreement to a consumer before he applies for the card. When a consumer applies for a credit card, his credit report is reviewed and an "inquiry" is placed on the file. More than five or six inquiries on a credit file in a six month period can lead to rejection for credit. Therefore, a consumer who really wants to shop around and read the fine print before signing up for a credit card can find it impossible to do so.

Another important provision in the bill is better disclosure of the grace period. The large majority of consumers that I have worked with believe that if your credit card offers a 25-day grace period, you get 25 days interest-free on all new credit card purchases. Again, that's not the case. If you carry a balance of just one dollar over from the previous month, you lose the grace period on all new purchases.

I have attached a letter from one of our members who got caught in the "grace period trap." This consumer had a balance of $1 on his April credit card bill. Because it was such a small balance, he decided it wasn't worth writing a check for – he would pay it the next month. (This consumer, by the way, typically pays his bill in full each month.) When he got his next month's bill, he was startled to find a finance charge for $2.99. Why?

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9. "The Annual Fee's Wake May Not Be a Tearjerker," *Credit Card News*, January 15, 1994, page 1.

10. Credit Card News, August 15, 1993.

Because he had failed to pay off that $1 balance, the grace period was erased, and the purchase he made in May – which he fully intended to pay in full – started incurring finance charges immediately.

Finally, Congressman Schumer has included a very important provision in his bill by requiring issuers to give consumers the option not to have information about their account or spending habits sold to other marketers. Credit card statements are a marketer's dream: they offer very detailed information about consumers' spending habits. There is currently no federal law preventing that information from being sold or otherwise used for marketing purposes. I think there is no question that exchanging that information without the consumer's consent would definitely be an unfair invasion of privacy.

There's no doubt that the industry is going to say the additional disclosure requirements before you today are going to be very expensive and that consumers will end up paying a higher price for credit as a result. We don't believe that we are talking about significant costs, and we also believe that the overall benefits of providing better information about the costs of credit to consumers will outweigh any initial costs to change their systems. We also believe that providing consumers with clear disclosure and better information about their choices contributes to a more competitive environment.

We want to thank Chairman Kennedy for holding this hearing today, and also thank Congressman Schumer for his continuing efforts to protect consumers against unfair credit practices.

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A non-profit organization helping bankcard holders become informed consumers.

INTEREST RATES IN THE ECONOMY

	Credit Cards	Discount Rate	Prime Rate	Margin*
1980	17.3%	11.5%	15%	5.8
1981	18.5%	13.3%	19%	5.2
1982	18.5%	11%	15%	7.5
1983	18.7%	8.5%	10.75%	10.2
1984	18.75%	8.8%	12%	9.95
1985	18.7%	7.75%	10%	10.95
1986	18.25%	6.4%	8.4%	11.85
1987	18.3%	5.7%	8.2%	12.6
1988	18.4%	6.2%	9.3%	12.2
1989	18.7%	6.9%	10.9%	11.8
1990	18.8%	6.98%	10.01%	11.82
1991	18.9%	5.0%	8.5%	13.9
1992	18%	3.25%	6.25%	14.75
1993	17.3%	3.0%	6.0%	14.3
Current 1994	16.5%	3.0%	6.0%	13.5

* For illustrative purposes, the margin is the difference between the average credit card interest rate and the discount rate. (The discount rate is the charge on loans to depository institutions by the Federal Reserve Banks).

Source: Bankcard Holders of America, Federal Reserve Board

▲ Detach here and return ▲

9989

SIGNET® BANK

VISA

It's Everywhere You Want To Be®

6.9% Fixed APR VISA® Card
If You Transfer A Balance
Pre-Approved Up To $6,500

Dear Gary D Serota, 251209256840-16

Congratulations! **You have already been approved** for our low-rate VISA credit card from Signet Bank. Normally, we offer this low-rate card at a 12.9% variable (LIBOR rate + 9.7%) annual percentage rate. However, if you transfer at least one balance, we will lower this rate even more to a fixed 6.9% for over one full year. Now you can make purchases with a **guaranteed annual percentage rate of ONLY 6.9%** until April 1995!

6.9% Fixed APR!

That's right...6.9%. One of the lowest rates in the nation. Many credit cards are at 19.8% or higher. In addition, this Pre-Approved card comes with an **initial credit line of up to $6,500**. And to meet your changing needs, we will periodically review your account for a credit line increase. Plus, you will receive a 25 day interest-free grace period on your purchases if you pay your balance in full each month.

Transfer Your Balances!

With this exceptionally low rate you can begin saving money immediately. Transfer balances from high APR bank and department store credit cards to your low 6.9% Signet card. Your transferred balances will have the same low APR as your purchases.

We make transferring balances easy...just complete the Optional Balance Transfer form enclosed, return it with your Pre-Approved Acceptance Certificate, and we'll do the rest. The best part is that we charge absolutely **no transfer fee** for this service!

With our 6.9% APR, your yearly savings can be substantial.

FIRST YEAR SAVINGS CHART

		If your average balance is...		
		$2,000	$4,000	$6,500
...and your current APR is...	9.9%	$60	$120	$195
	15.9%	$180	$360	$585
	21.9%	$300	$600	$975

(over, please)


GREAT IDEAS
Now Get More!
Introducing
ROOMS & MORE
The Smart Way to Shop
For All Your Home Furnishings.
By The Piece. By The Group. By The Room
999 Biscayne 7 piece
Living Room Group—just
$25 a month!
Now Pay Less!
Announcing
New Lower
Monthly Payments
New Monthly Payments That Are
1/40th Of Your Highest Account Balance!
Montgomery Ward
123 456 789
MARY SMITH
Montgomery Ward
Things are changing

Now You'll Pay Less And...

Increase Your Buying Power!

Montgomery Ward

123 456 789

HARY SMITH

We're making it easier for you to afford purchases with your Montgomery Ward Credit Card.

We're converting your entire account to our new 1/40th repayment terms. That means you can buy more without straining you budget. And you may pay less each month for the same great brand-name merchandise

The New 1/40th Minimum Payment

These terms are now available to all cardholders beginning with your October statement. Under these terms, your minimum monthly payment will be 1/40th of you highest balance. (Currently you pay at least 1/30th of your balance each month.)

Other stores require you to pay almost twice as much!

COMPARE YOUR MONTGO

Compare these paym

Monthly payment:

Montgomery Ward		SILO	CIRCUIT C
$13 NEW 1/40th	$17 OLD 1/30th	$20	$17

Why are we making this change?

The answer is YOU.
Your business
is important to us
and we want to do
everything possible
to make your shopping
easier and
more convenient.

2 Benefits Of This Change

1. **The same payment buys you more.** Under the 1/30th terms, a $20 monthly payment lets you buy an item costing $600. Now that same payment lets you buy $800 worth of Montgomery Ward merchandise. That's an extra $200 with no more to pay each month

2. **Lower minimum payments put more in you budget.** 1/40th terms mean your minimum monthly payments may be 25% lower for the same item. So if you were putting off some of those large purchases because the monthly payment was too high, now you can choose to buy.

MERY WARD MINIMUM PAYMENT

ents based on a $500 purchase

We challenge you to find lower monthly payments on comparable items anywhere else

Here's just a sample of the Montgomery Ward difference

999[99] Compaq Personal Computer
NOW Just $25 a month
COMPARE!
Circuit City............$35 a month
Best Buy.................$30 a month
See Name of Item details on page 3

699[99] Maytag Range
NOW Just $18 a month
COMPARE!
Best Buy..................$21 a month
Circuit City...............$24 a month
See Name of item details on page 6

999[99] Biscayne7 Piece Living Room Group
NOW Just $25 a month
COMPARE!
Wickes.....................$35 a month
Levitz......................$42 a month
See Name of item details on page 10

EXPRESS CREDIT ....JUST 3 MINUTES!
Montgomery Ward
Your Name Here

Don't Have A Card? Turn The Page...

Announcing · New Lower Monthly Payments!

An easier way for you to afford purchases with your Montgomery Ward Credit Card.

We're converting your entire account to our new 1/40th repayment terms. That means you can buy more without straining your budget. And you may pay less each month for the same brand names!

EXPRESS CREDIT.......JUST 3 MINUTES!

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It's That Fast. It's That Easy.

You can get a Montgomery Ward credit card in only 3 minutes! We can process your application while you check out!

Subject to credit approval.

Montgomery Ward
· Things are **Changing**

We challenge you to find lower monthly payments on equally priced items anywhere else!

Here's just a sample of the Montgomery Ward difference

2 CT T.W. Diamond Bracelet

NOW Just $25 a month

COMPARE!
Service Merchandise.......$50 a month
JC Penney.......$41 a month
See Bracelet details on page 24

Revue Sofa By Bassett

NOW Just $13 a month

COMPARE!
Wickes.......$25 a month
Levitz.......$37 a month
See Bassett Sofa details on page 10

GE Direct View Stereo Color TV

NOW Just $20 a month

COMPARE!
Circuit City.......$28 a month
Best Buy.......$24 a month
See GE TV details on page 4

1 CT T.W Ladies Diamond Ring

NOW Just $15 a month

COMPARE!
Service Merchandise.......$30 a month
JC Penney.......$27 a month
See Diamond Ring details on page 24

Pair Of Dual Massage Chaise Recliners

NOW Just $13 a month

COMPARE!
Wickes.......$15 a month
Levitz.......$16 a month
See Recliner details on page 29

Amana 22 Cu. Ft. Refrigerator

NOW Just $30 a month

COMPARE!
Best Buy.......$36 a month
Circuit City.......$42 a month
See Amana Refrigerator details on page 6

CHOICE

4135031360142000100000100580 37

Payment Due Date	Your Total Balance	Minimum Payment Due	Please Enter Amount Of Payment Enclosed
MAY 29 1993	$1.00	$1.00	

37432B VC 00 AB 0988 1

CHOICE VISA
P.O. BOX 6704
SIOUX FALLS, SD
USA 57188-6704

RAFAEL E [redacted]

RIDGEFIELD NJ 07657-1623

( ) New Home Phone ( ) New Business Phone

Please print Change of Address or Phone Number above.

CHOICE

For Customer Service call or write
800-934-2788

BOX 6248
SIOUX FALLS, SD
57117

For billing inquiries write to the address listed. Calling will not preserve your rights.

Account Number [redacted] CHOICE VISA

PAYMENT DUE DATE 05/29/93

Statement Date	Total Credit Line	Cash Advance Limit*	New Balance	Available Credit Line	Available Cash Line †
05/05/93	$5500	$2800	$1.00	$5499	$2800

Sale Date	Post Date	Reference Number	Activity Since Last Statement	Amount
4/27	4/27	GNVRH9KG	AUTOVANTAGE MEMBERSHIP TX ***QUESTIONS CALL 1-800-876-7787	1.00

If you transfer a balance from a non-Citibank card, you will receive a special low rate on your transferred balance as well as all new purchases through 09/30/93. For more information, please call Customer Service.

Your Cardmember Agreement states that we add any new purchases, cash advances, or adjustments as of the day made or received, whichever is later. It should state that unless we elect to use a later date, we add them as of the date of purchase or transaction.

Account Summary

	Previous Balance	(+) Purchases & Advances	(-) Payments	(-) Credits	(+) Finance Charge	(+) Late Charges	(=) New Balance
Purchases		1.00					1.00
Advances							
Total		1.00					1.00

Amount Due

Payment Due	1.00
Amount Over Credit Limit	
Past Due	
Minimum Amount Due	1.00

Rate Summary	Purchases	Advances
Number of days this Billing Period 30		
Balance Subject to Finance Charge		
Periodic Rate	1.28330%	.04219%
Nominal Annual Percentage Rate	15.40%	15.40%
Annual Percentage Rate	15.40%	15.40%

SEND PAYMENTS TO: CHOICE VISA P.O. BOX 6704 SIOUX FALLS, SD 57188-6704 37432B

*Cash Advance Limit is a Portion of Your Total Credit Line
† Available Cash Line is a Portion of Your Available Credit Line.

Citibank (Maryland) N.A. Member F.D.I.C.

413503136014202939900110058031

Your Account Number [redacted]

Payment Due Date	Your Total Balance	Minimum Payment Due	Please Enter Amount Of Payment Enclosed
JUN 29 1993	$293.99	$11.00	

36738B VC 00 AB 0988 1

CHOICE VISA
P.O. BOX 6704
SIOUX FALLS, SD
USA 57188-6704

RAFAEL E [redacted]
RIDGEFIELD NJ 07657-1623

( ) New Home Phone ( ) New Business Phone
Please print Change of Address or Phone Number above.

'HOICE

For Customer Service call or write
800-934-2788
BOX 6248
SIOUX FALLS, SD
57117

For billing inquiries write to this address only; calling will not preserve your rights.

:count Number [redacted]
YMENT DUE DATE 06/29/93

atement Date	Total Credit Line	Cash Advance Limit*	New Balance	Available Credit Line	Available Cash Line †
/04/93	$5500	$2800	$293.99	$5206	$2808

Date	Post Date	Reference Number	Activity Since Last Statement			Amount
/11	5/11	YX5V7C8S	OPTICAL VISION INC	UNION CITY	NJ	290.00

If you transfer a balance from a non-Citibank card, you will receive a special low rate on your transferred balance as well as all new purchases through 09/30/93. For more information, please call Customer Service.

Don't forget! Prompt payment of at least the minimum amount due by your payment due date is required so you can continue to enjoy your low rate.

CLOSED ACCOUNT 061193 @ 1:20P - MRS. BANK

:count Summary

	Previous Balance	(+) Purchases & Advances	(-) Payments	(-) Credits	(+) Finance Charge	(+) Late Charges	(=) New Balance
rchases	1.00	290.00			2.99		293.99
lvances							
tal	1.00	290.00			2.99		295.99

Amount Due	
Payment Due	10.00
Amount Over Credit Limit	
Past Due	1.00
Minimum Amount Due	11.00

ite Summary	Purchases	Advances
mber of days this Billing Period 30		
lance Subject to Finance Charge	233.00	
riodic Rate (Purchases-Monthly, Advances-Daily)	1.28330%	.04219%
minal Annual Percentage Rate	15.40%	15.40%
nnual Percentage Rate	15.40%	15.40%

END PAYMENTS TO: CHOICE VISA P.O. BOX 6704 SIOUX FALLS, SD 57188-6704 36738B

*Cash Advance Limit is a Portion of Your Total Credit Line
†Available Cash Line is a Portion of Your Available Credit Line.

Citibank (Maryland), N.A. Member FDIC

Testimony by
Frank O'Leary, Arlington County Treasurer
before the
House Banking, Finance, and Urban Affairs
Subcommittee on Consumer Credit and Insurance

February 10, 1994

Mr. Chairman, members of the Committee, I am Frank O'Leary, the elected Treasurer of Arlington, Virginia. I would like to thank Congressman Jim Moran for sponsoring HR 2175, and to thank you for holding these hearings.

As an elected official, it is my intense desire to ensure that the citizens of Arlington receive the highest level of government services, at least cost. Further, I seek to maximize their convenience and, in the area of revenue collection, to make the process as painless as possible. I believe the enactment of HR 2175 would vitally enhance my service to the public, and that of local finance officers across the nation.

It is with these objectives in mind, that, in 1985, I instituted our program of payment by credit card. Since then, Arlington County has become the most intense user of credit cards for the payment of government bills in the nation. During the last fiscal year, more than 12,000 payments totalling $3.8 million were processed. This is a far greater volume than that realized by jurisdictions many times Arlington's size.

Since the inception of our program, the service fee for use of the card has been borne by the cardholder. This is a departure from the practice in the private sector, where the business establishment pays the so called "merchant fee" and passes on the costs of doing so to all its customers. Over the last nine years, not one of the many thousands of Arlington taxpayers served by the credit card program has complained to me over having to pay the fee. They realize that paying a small processing fee is far preferable to paying a large late payment penalty.

By offering credit card services, we have improved the financial situations of many Arlington citizens and reduced the fines and penalties which they might otherwise have incurred. Unlike a private business, we did not introduce credit cards as a means of payment in order to increase county revenues or to meet the challenge of a competitor. This is because most of our revenues arise from "mandatory payments."

A mandatory payment is a tax, licensing fee, permit fee, or other bill which a citizen is absolutely obliged to pay. Accordingly, the volume of mandatory payments is virtually unaffected by whether or not a credit card is employed. Further, when payment is not received in a timely manner, the citizen suffers the consequences by the imposition of late payment penalties and subsequent enforcement actions. Mandatory payments are essential to ensure that government receives the funds necessary to provide police and fire protection, education, and other vital services for the people. These funds are the "life blood" of essential services.

By contrast, governments might also decide to provide non-essential goods and services which citizens might purchase on a "voluntary basis." Recreation, daycare, adult education, and the sale of miscellaneous items are all cases where government acts as a "merchant." Further, the level of associated revenue may be positively affected by allowing credit card charges, and involvement by the citizen is absolutely "voluntary." In Arlington, the credit card service fees for all such "voluntary payments" are borne by the government. In short, when government chooses to act as a merchant, government should be treated as a merchant and should absorb the cost of credit card fees.

A departure from these precepts on the part of government is logically unsound and politically untenable. Based on a recent national survey, the average credit card fee applied by Visa/MasterCard to government-based credit card transactions is approximately 2.93 percent. Imagine then a citizen arriving at a treasurer's office, credit card in hand, to pay a $1,000 real estate bill - a bill he must pay and the treasurer must collect, regardless of payment method. What possible justification is there for a treasurer to incur a charge of $29.30 to receive a payment which must be made in any event or, if late in payment, must be collected with an added penalty of $100.00 or more? How could acceptance of such excessive costs by a treasurer be defended before the overwhelming majority of taxpayers (a.k.a. "voters") who chose to pay their tax bill by check or cash, where the attendant processing cost is measured only in pennies?

Multiply this concept. There are individual citizens throughout this nation with local tax bills on the order of $10,000. Can any sensible person advance the theory that local government should pay nearly $300.00 for the receipt of such a

payment? If government were foolish enough to do so, there would be tremendous incentive for the relatively wealthy to charge their taxes on credit cards. By doing so, they would defer ultimate payment (to the issuer of their credit card) by six to seven weeks. During that same period, their funds might be invested in a mutual fund earning them as much as $300.00 or more. How could any treasurer justify to his or her constituents a program under which the, supposedly neutral, process of collection benefits a minority at the expense of all taxpayers?

Now consider citizens at the other end of the income spectrum. For many of them, credit cards have become a necessity. In their absence, these citizens will fail to discharge their mandatory payments in a timely manner. They may then incur severe financial penalties. At a minimum, a 10 percent late payment penalty will be imposed. Worse yet, in some jurisdictions the penalty continues to double and triple in succeeding months. In the case of jurisdictions such as Arlington County, where the personal property tax is a basic source of revenue, confiscation of the vehicle on which taxes are owed may ensue, with an attendant towing fee on the order of $80.00. Repeated ticketing by police (at, perhaps, $40.00 per citation), seizure of wages, public ridicule when delinquency lists are published, stress, tension, and a loss of self-esteem are all possible consequences.

Visa/MasterCard have systematically terminated credit card services for hundreds of state and local governments across the country for no other reason than because these state and local governments have added the amount of the credit card fee to the amount owed by the taxpayer using a credit card. Visa/MasterCard say they have taken this action because it is discriminatory to charge the taxpayer the user fee, even though allowing the taxpayer to charge his or her mandatory payments may be saving the taxpayer money.

By cutting off these government entities Visa/MasterCard have done a major disservice to citizens of modest income throughout this nation. It is particularly sad that they have caused this misery solely over the issue of who pays the user fee. Clearly, they wish to conceal from these consumers the true costs of using credit cards, in the fear that knowledge will constrain use. Ironically, it is Visa/MasterCard who, in fact, discriminate by allowing truckstops and gambling casinos to pass on the

user fee to the cardholder. Why is it that these institutions have more influence with Visa/MasterCard than government?

While we believe that the taxpayer should bear the credit card fee in making mandatory payments, we also strongly believe that those charges should not be excessive. The charges imposed by Visa/MasterCard for processing a payment must be compared with the costs of alternative methods of payment (see attachment). The charge for receiving payment by check or money order is approximately $.06. A charge to a debit card runs about $.75. Most relevantly, **Discover Card** has entered into a contract with Arlington County whereby **cardholders are charged a flat fee of $1.00 on all payments up to $200, and $2.00 thereafter.** Similar agreements are being entered into elsewhere by Discover Card. How is it possible for Visa/MasterCard to charge government with "discrimination" for refusing to swallow, and, instead, to pass on to freely consenting taxpayers, their onerous fee?

Accordingly, we, America's treasurers and finance officers, turn to you to break the impasse with Visa/Mastercard. Our professional organizations -- the Government Finance Officers Association; the Municipal Treasurers' Association; the National Association of Counties; the National Association of County Treasurers and Finance Officers; the National Association of State Treasurers; the National Association of State Auditors, Comptrollers, and Treasurers; and the American Association of Motor Vehicle Administrators -- all support HR 2175. By enacting this legislation, you can restore a vital service to millions of Americans.

Mr. Chairman, that concludes my remarks. Thank you for providing me this opportunity. I am prepared to answer any questions on this subject.

TYPICAL CHARGES FOR VARIOUS FORMS OF PAYMENT AND WHO USUALLY BEARS THE CHARGE

PAYMENT TYPE	TYPICAL CHARGE FOR VARIOUS PAYMENT AMOUNTS			EXPLANATION
	$50.00	$200.00	$1,000.00	
CASH	$0.005	$0.005	$0.005	Annual armored car service costs per transaction. Cost is borne by governmental entity.
CHECK/MONEYORDER	$0.06	$0.06	$0.06	Charge per check deposited plus monthly maintenance fees borne by governmental entity.
ACH	$0.08	$0.08	$0.08	Stated current cost per transaction charged by a bank. Charge is borne by governmental entity.
DEBIT CARD	$0.75	$0.75	$0.75	Stated current cost per transaction charged by a bank. Charge is borne by taxpayer.
WIRE TRANSFER	$4.00	$4.00	$4.00	Stated current cost per transaction charged by a bank. Used only for very large transactions (e.g.; $50,000 +). Charge is borne by governmental entity.
DISCOVER CARD	$1.00	$2.00	$5.00	Average charges under governmental contracts. Charge is borne by taxpayer.
VISA/MASTERCARD	$1.45	$5.80	$29.00	Based on an average fee of 2.9 percent. Visa/Mastercard demands that charge be borne by governmental entity.

STATEMENT OF

MASTERCARD INTERNATIONAL INCORPORATED

BEFORE THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

ON H.R. 2175

FEBRUARY 10, 1994

MasterCard International Incorporated ("MasterCard") appreciates the opportunity to appear before the Subcommittee on Consumer Credit and Insurance ("Subcommittee") of the House Committee on Banking, Finance and Urban Affairs to discuss H.R. 2175. We request that our testimony be made part of the record of the hearing.

MasterCard has established a series of rules and procedures for all who accept MasterCard cards in payment for goods and services. These rules are intended, among other things, to fulfill our cardholders' reasonable expectation that their MasterCard cards will be honored in a uniform and non-discriminatory manner by all persons who accept MasterCard cards for payment. Our "no surcharging" policy in particular ensures that our cardholders are not forced to pay more than the posted price when they use their MasterCard cards.

About a year ago, MasterCard reexamined and reaffirmed its no-surcharge policy. Government agencies, including a few who had in the past been permitted by MasterCard to surcharge, were informed that they would no longer be permitted to do so. Many government agencies continue to accept MasterCard cards, despite its no-surcharge policy. Some have elected not to accept MasterCard as a result of its policy. A few agencies that had been permitted to surcharge continue to do so but have been notified that they must cease the practice by March 31, 1994. MasterCard believes that each credit card company should be free to establish its own policy with respect to surcharging, and that government agencies should be allowed to decide for themselves which, if any, cards to accept. The surcharge issue is best addressed through this traditional competitive process.

H.R. 2175 as introduced provides that a card issuer may not prohibit a federal, state or local government agency from assessing and collecting from the user of a credit card a fee for honoring the card. Although its effect is not entirely clear, the bill apparently is intended to allow federal, state and local government agencies that accept credit cards to impose on consumers a surcharge for making a payment by credit card.

Congress has previously considered the appropriateness of credit card surcharges. When it last acted on the issue, Congress enacted a complete federal prohibition on credit card surcharges. This federal surcharge prohibition applied to all credit card transactions, and thus precluded surcharges by governmental entities as well as private retail merchants.

Although this federal surcharge prohibition lapsed in 1984, the issues and concerns which led to the enactment of the prohibition are still valid. Most significantly, credit card surcharges are anti-consumer. Credit card surcharges effectively discriminate against consumers who wish to make payment by credit card, rather than by cash, check or other means. More specifically, credit card surcharges impose on cardholders the cost of using the credit card payment system, while the costs incurred by the particular governmental entity or retail merchant to accept payments by cash or check -- which may be as much or even more -- are borne by the merchants.

The anti-consumer effect of credit card surcharges is most significant for less economically fortunate consumers. Consumers with cash or other sources of available funds can avoid paying a surcharge simply by using another form of payment, such as cash or check. However, consumers who do not have such funds

available when the government payment is due might be compelled to pay by credit card and incur the surcharge. In effect, they must pay an extra government tax because of their inability to pay by cash or check.

Such anti-consumer effects are difficult to justify under any circumstances. However they are particularly difficult to defend in the case of credit card surcharges since there has been scant evidence of any real need or justification for permitting government agencies to impose surcharges.

In this regard, the legislation assumes that credit card transactions are significantly more expensive for government agencies than other forms of payment merely because of the "merchant discount" that government agencies may have to pay for credit card transactions. In fact, the opposite is often true. Credit card payments actually can create significant efficiencies for government agencies, such as reducing losses from "bounced" checks and providing funds more quickly than other payment mechanisms. Credit card acceptance also allows agencies to avoid the transportation and other security costs of handling cash payments. Such savings reduce and can offset entirely the cost of a merchant discount and cast serious doubt on the justification for surcharges.

H.R. 2175 also raises a number of other serious issues. For example, the bill contains no limitations on the circumstances under which government agencies can impose credit card surcharges. Therefore, the bill would permit surcharges on consumers in entirely inappropriate circumstances.

For example, the bill presumably would allow a government agency to impose surcharges on virtually any credit card payment, including payments made

at government owned "retail" operations, such as state liquor stores or gift shops. It also would allow every local government office and official in the entire country to impose surcharges, regardless of the nature or purpose of the particular government activity or the size or reason for the particular payment.

Moreover, although the bill is intended to address government agencies, we are concerned with the effect it may have on other merchants. For example, if any entity owned or administered by a government agency, such as public utilities, state liquor stores, franchise holders at airports and parks, museum gift shops, university book stores, etc., is permitted to surcharge, then privately-owned competitors of such "government" entities may feel disadvantaged and insist that they, too, be permitted to surcharge. As a result, consumers may end up paying many more surcharges than Congress intended.

In addition, the bill contains no limitation on the amount of the surcharge that could be imposed on any consumer. It does not even require that there be any relationship between the size of the surcharge and the cost of that credit card transaction to the government agency. And government agencies would be permitted under the bill to impose surcharges without giving prior notice to consumers.

Thus, H.R. 2175 would allow state and local government agencies to impose hidden taxes on consumers by charging surcharges that are higher than the cost actually incurred by those agencies for their credit card transactions. Congress should not permit government agencies to impose unlimited surcharges on consumers.

The bill also would create significant confusion on the part of consumers. Some states have prohibitions against imposing surcharges, and credit card systems generally prohibit credit card surcharges to avoid cardholder abuse. The bill, by allowing credit card surcharges in connection with government payments when surcharges are prohibited for virtually all other payments, will result in consumer confusion and complaints. Consumers generally know that merchants cannot apply a surcharge or additional fee to a credit card payment with the rare exception of service fees applied to advance ticket sales which must be indicated to the consumer at the time of purchase.

By facilitating government acceptance of credit cards, the bill also would create significant potential for bankruptcy abuse. For instance, when government agencies accept credit cards, cardholders can convert some obligations, such as tax liabilities, which are <u>not</u> dischargeable in bankruptcy into dischargeable credit card debts. This result, which could cause hundreds of millions of dollars in bankruptcy losses to card issuers, simply could not have been intended by the bill's sponsors.

Finally, as the Subcommittee considers the merits of this legislation, MasterCard urges careful evaluation of the implication of Congress inserting itself into the contractual negotiations between numerous credit card companies and thousands of government agencies. There may be circumstances in which it is appropriate for Congress to dictate the terms under which the private sector must do business with government agencies, such as in wartime or during other national emergencies. Absent extraordinary circumstances, however, we question the need for -- and the constitutionality of -- such intervention.

Therefore, MasterCard opposes H.R. 2175 on the basis that it is anti-consumer, it ignores the cost efficiencies experienced by credit card acceptors and it involves unjustified government intervention into the private sector.

Thank you, Mr. Chairman.

76-346 0 - 95 - 4

STATEMENT OF

VISA U.S.A. INC.

BEFORE THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

ON H.R. 2175

FEBRUARY 10, 1994

Mr. Chairman, members of the Consumer Credit and Insurance Subcommittee of the Banking, Finance and Urban Affairs Committee ("Subcommittee"), my name is Linda Mock. I am Group Vice President for Market Development for Visa U.S.A. Inc. ("Visa"). On behalf of Visa, I appreciate this opportunity to appear before the Subcommittee to present our views on H.R. 2175, which would amend the Truth in Lending Act to permit a federal, state or local government agency to assess a fee against a consumer who chooses to make payment with a credit card. We request that our testimony be made part of the record of the hearing.

Visa strongly opposes H.R. 2175 for several reasons. First, on public policy grounds, the government should not intervene with its own notion of pricing and pricing methods when the market affected -- general purpose payment cards -- is demonstrably efficient; is without any evidence of (in economists' lexicon) "market failure"; delivers value to consumers and where the parties affected, particularly the government agencies at issue, have perfectly adequate methods to accept such cards today within the Visa rules.

Second, payment card surcharges at the point of sale harm the Visa product by discouraging usage, and by causing consumer confusion as to the locales where surcharging is permitted and the amounts levied.

Third, surcharges are extremely anti-consumer, discriminating particularly against those who may not have the means to pay their obligations with cash or by check. In fact, by permitting surcharges, H.R. 2175 actually penalizes consumers who pay with a card.

Fourth, the bill encourages - and actually subsidizes - continued government inefficiency by offering agencies a quick fix to meet any costs associated with

acceptance, rather than forcing them to respond as the private sector must: in a creative, efficient, consumer-friendly manner.

BACKGROUND

Visa is a membership association comprised of over 14,000 U.S. financial institutions that are licensed to use the Visa service marks in connection with payment services, including issuance of credit and debit cards.

The Visa Operating Regulations generally prohibit anyone accepting the card from assessing consumer surcharges. The rule was developed in order to encourage credit and debit card use as a convenient alternative to cash and checks that also has substantial benefits to the "merchant" (the private business or government agency that accepts the card for payment). Thus, the rule is based on the premise that credit cards (and debit cards) should be treated like cash or checks in the eyes of consumers and merchants. This principle, now twenty-five years old, is one of the reasons Visa has become the world's largest consumer payment system and has seen payment service volume grow 22% annually for the last 10 years to over $529 billion.

Card acceptance offers significant benefits for both governmental entities and consumers that offset and justify the associated cost. These benefits include:

- A convenient payment method;
- Payment flexibility in meeting obligations, thereby promoting more timely payment, which in turn, lowers government interest costs and peak period processing costs;
- Guaranteed payment (not true of checks), reduced bad check processing and collection costs;
- Improved funds availability, generally next day;

- Use of innovative, automated payment programs that reduce handling costs and losses associated with cash and checks.

By offering more payment options, card acceptance can also lead to more government revenue. It can increase use of discretionary government services, like parking lots or parks. It can even lead to increased collection of mandatory payments such as fines, court costs and taxes. Surcharges, however, will discourage card use and prevent government entities from realizing these potential benefits.

Government entities at each of the federal, state and local levels perform many different functions that can be grouped into three broad categories:

- Those involved in tax collection and administration for income taxes, customs levies or property taxes, for example.

- Those responsible for mandated payments such as fines, penalties, health services, court fees, permits or vehicle registration.

- Those providing goods and services such as postal services, park and recreation services, liquor stores, college and university tuition, highway tolls and transportation fares.

Clearly, in this diverse market, a single pricing method may not be appropriate across the board. And, although the Visa rules prohibit surcharges, each "acquirer" (a financial institution that contracts with a merchant to accept payment cards) has complete freedom to negotiate with any merchant the way in which the acquirer will be paid for its services. We have worked with numerous government agencies and our member financial

institutions to permit Visa cards to be accepted in the government market in accordance with our current rules. For this reason more than 2000 government entities now accept Visa cards but do not assess surcharges. The United States Treasury/Financial Management Services; the City of Baton Rouge, Louisiana; Midway Airport, Illinois; Sedgwick County, Kansas; the City of Toledo, Ohio; Treasurer, Indiana University, Indiana and the California Department of Motor Vehicles are only a few examples. These entities are cognizant of the vital consumer issues at stake and have been willing to adopt private sector solutions to card acceptance.

DISCUSSION

Government Intervention in Pricing is Inappropriate;

Competition Should Determine Pricing Policy, Not the Government

Given that alternative payment mechanisms obviously are available to anyone who does not want to abide by Visa's rules, it is highly inappropriate for the government to intervene in the decision-making and market strategy of a private business, such as Visa, in order to force Visa to allow certain of its customers to levy surcharges. Absent a "market failure", the government should not to impose its view of pricing on the private sector, especially in an industry that is highly competitive.

Numerous studies have found that the payment card industry is intensely competitive. Most recently, this was confirmed in a new study entitled "The Economics of the Payment Card Industry", just released by National Economic Research Associates, Inc. and authored by Richard L. Schmalensee of the Massachusetts Institute of Technology and David S. Evans of Fordham

University School of Law. The authors examined in detail the complex and highly competitive nature of the payment card industry, noting that through competition consumers receive the best prices, service and innovation without government intervention. Such intervention is appropriate only where there is a market failure, which they found does not exist in the payment card industry. In addition, government interference with pricing is particularly detrimental since it intrudes into the most sensitive area of market planning.

And, once the government approves imposition of surcharges for itself, how does it justify not extending them to the private sector? There is no basis for Congress to substitute its judgment regarding pricing for that of the card industry or any other competitive market.

The Government Has Alternatives to Surcharges

Alternative payment mechanisms, such as cash and checks, are available to any private or government business that does not want to abide by Visa's rules. However, more than 2000 creative, responsive government entities <u>do</u> take credit cards in a consumer-friendly manner within the Visa rules (*i.e.*, without surcharges). They have done so by working with financial institutions to develop a total banking package that may include card acceptance, cash management services, payment through compensating balance, check processing and other financial services. Such practices provide an adequate return to the financial institution, savings to the agency, and benefits to the consumer.

In addition, governments and traditional merchants may levy a "convenience fee" for <u>all</u> forms of payment, which would not unfairly discriminate against

credit cards. Also, government agencies have been known to negotiate with their bank partners payment of a flat fee, in lieu of the traditional percentage on the sale price, on payments above a particular amount. Such arrangements are acceptable under Visa rules. Indeed, banks that sign merchants for Visa card acceptance are free to negotiate any financial arrangement they choose; Visa has no restrictions on the financial arrangements between any merchant and its bank partner.

Under still another alternative, the state or local treasurer may sign a master contract with an acquirer that covers any agencies within his or her jurisdiction that wish to accept cards. Some costs are paid directly by each agency; the treasurer pays the others. Since the "merchant discount rate" typically declines as transaction volume increases, the broader the participation within the jurisdiction, the lower the cost of card acceptance.

The government markets are of prime importance to Visa, and while we oppose surcharges, we are working with all sectors of government to find solutions that will facilitate card acceptance. At this moment, we are evaluating business plans, payment alternatives and technological enhancements. We are dedicating considerable resources and energy to assessing the best and most efficient ways to meet the needs of each of these segments, consumers and Visa's member financial institutions.

Surcharges Would Harm the Visa Product

The value of our product would be harmed if consumers were required to pay a surcharge for using it. For card acceptance to meet the needs of government agencies, the interests of all parties involved must be balanced. That includes the government, the consumers and the financial institutions that make up the Visa system and other payment card systems. Passing all

of the costs onto the consumer as a surcharge does not meet this test. Rather, it is anti-consumer and diminishes the value of card products by decreasing their perceived utility as a substitute for cash and checks, which may be used at no cost to the consumer.

By making card users pay more than users of cash or checks, surcharges change the basic service that card issuers offer their customers. Surcharges lead to consumer confusion and complaints, because consumers would not know in advance of payment which agencies or other merchant establishments levy surcharges or the amount of these extra charges. Obviously, surcharges increase costs for consumers and diminish the value to consumers of using payment cards, thereby damaging the Visa product

H.R. 2175 also raises serious shortcomings, that harm the Visa product. While making sure government entities get "paid in full", it does not provide similar protection for card issuers, thus creating significant potential for bankruptcy abuse. By paying a tax obligation with a credit card, a cardholder can convert a tax liability from nondischargable in bankruptcy to a dischargeable credit card debt. This could result in hundreds of millions of dollars in losses to card issuers.

The utility of our product and all payment cards would be severely impaired if consumers were levied a surcharge for using them, even in the government arena.

<u>Surcharges Are Anti-Consumer</u>

Surcharges are not in the consumer's best interest, particularly because they discriminate against those who may not have the means to pay their

obligations with cash or by check. In fact, by permitting surcharges, H.R. 2175 actually penalizes consumers who pay with a card.

Consumers view surcharges as a hidden cost. Thus, a department of motor vehicles that surcharges while encouraging motorists to pay their fees with a payment card in order to ease its administrative burdens and receive faster (and guaranteed) payment actually increases the tax liability on those who help make the Department more efficient - the cardholders. Not only does this act as a disincentive to card use, but research indicates that surcharges are likely to result in a higher than normal rate of delinquency and charge-offs, and thus increased losses to the payment card system.

All forms of payment, including cash and checks, have costs associated with them. Indeed, credit card costs are often lower than check costs. Yet surcharges require card users to pay not only for the costs of card acceptance but also for the costs of handling cash and checks, for which there are no corresponding consumer charges. As with the costs of cash and checks, the cost of accepting cards should be treated as a general cost of operation.

In addition, levying surcharges on card users adversely affects in particular consumers of modest means because they are the ones most likely to need the flexibility of credit card use when faced with a tax payment or an unexpected bill. Consumers with available funds can readily avoid paying a surcharge simply by using another form of payment, such as cash or a check, while consumers who do not have sufficient funds are forced to incur the surcharge by paying with a credit card.

In addition to the potential for bankruptcy abuse, H.R. 2175 also raises other shortcomings that hurt consumers. The bill does not limit the amount of the surcharge that may be imposed on consumers. It does not require that there

be any relationship between the amount of the surcharge and the cost of the transaction to the agency, thus creating serious potential for hidden taxes by agencies that levy surcharges in excess of their costs. Nor does it require any notice to consumers by the surcharging government entity of the impending charge.

In addition, it places no limitations on the circumstances under which the government can levy a surcharge and thus permits them at government-owned "retail" facilities, such as state liquor stores, parking lots and recreation areas that compete with the private sector.

Some agencies have incongruously taken the position the extended payment feature of credit cards permits consumers who may be short of funds to pay on time, thus saving themselves a penalty for late payment, *i.e.*, a two percent surcharge is better than a ten percent late penalty. Visa views this as a curious rationalization. In addition, it overlooks the majority of taxpayers who routinely pay on time and would be penalized for using the payment medium the government wants to encourage. The easy way out is not the best way out.

<u>Surcharges Unnecessarily Carve out Government for Special</u>

Surcharges offer agencies the illusion of a quick fix, but more creative, efficient, consumer-friendly responses, such as those adopted in the private sector, would be more appropriate.

Government acceptance of payment cards is an excellent way to take advantage of advanced technologies to enhance and simplify the government payment process. However, permitting agencies to levy a surcharge on

consumers who choose - with the government's encouragement - to take advantage of this convenient payment medium is not likely to encourage use. Governments, like all businesses, use and pay for a variety of financial services, incorporating the costs into their overall operating budgets. Card acceptance should not be treated differently nor should the government be able to give itself preferential pricing.

Some government entities do not understand payment card pricing, but Visa has worked diligently with them and will continue to do so. We believe once governments understand the economics of the business and their many pricing options, they will agree --- as have hundreds of entities already -- that payment card acceptance <u>without</u> surcharges makes good sense.

By way of illustration, government agencies may claim that merchant discounts should not apply to government payments. "Discount" is a misnomer. What the bankcard industry traditionally calls the "merchant discount" actually refers to the administrative and processing costs of acquirers and issuers. These costs are no different from those incurred for other forms of payment. Check handling and collection costs are viewed neither as a reduction in the amount collected nor passed on to check writers as a surcharge. They are considered general operations costs. The cost of accepting cards should be treated the same way.

In addition to payment services, state and local governmental units use and pay for a wide range of financial services in performing their public missions, such as bond underwriting, investment management and cash management. Why should credit cards be different?

Other jurisdictions believe that to pay processing and administrative costs for card acceptance would violate laws requiring "payment in full". Visa

believes this is a misinterpretation of the law. With card payment, as with all forms of payment, the consumer pays the full amount. When the agency deposits the transaction with its acquirer, the acquirer credits the agency's account for the amount of the deposit minus a fee to cover the processing and administrative costs for the transaction. The agency enters the full amount in its books and records the fee as an expense, like any other operating cost. Accordingly, there is no conflict between card acceptance and laws requiring payment in full. The acquirer could just as easily deposit the full amount in the agency's account and debit the fee as a separate transaction.

CONCLUSION

Visa believes that the proposed legislation is not in the best interest of consumers, government agencies themselves, or the members of the payment card industry. The most persuasive proof of the wisdom of a "no surcharge" policy is the extraordinary worldwide consumer acceptance of such cards, particularly in the last decade. One cannot seriously suggest that such acceptance would have occurred if consumers were surcharged at the point of sale. Indeed, the ubiquity of credit cards and the vast number of merchant locations that accept them is eloquent testimony that credit cards are rapidly displacing cash and checks in the eyes of consumers. A return to the days of surcharging will surely adversely affect the continued growth of this vital U.S. industry.

Economists generally agree that government intervention in the markets, particularly pricing intervention, is ill-advised without sound proof of some "market failure"; an intervention that is specifically designed to correct the failure; and, even then, intervention only when the benefits clearly outweigh the costs. There surely has been no showing in this instance that this test has been met. This is particularly telling since hundreds of government

agencies already accept Visa cards for payment without imposing surcharges on consumers. They do so through financial arrangements with their banking partners that are not unlike those used by millions of merchants in the private sector, and millions more worldwide. With due respect to the government agencies that, we concede, are hard pressed financially, Visa cards can be accepted for payment today. Nonetheless, as the industry leader in designing custom payment services for particular market segments, Visa continues to study the government market and to consider even better ways to serve all our customers -- the government entities, the consumers, and the thousands of banks that issue Visa cards and act as acquirers for merchants throughout the country.

TESTIMONY

of

Jeffrey L. Esser
Executive Director
Government Finance Officers Association

on behalf of

Government Finance Officers Association (GFOA)
Municipal Treasurers' Association (MTA)
National Association of Counties (NACO)
National Association of County Treasurers and Finance Officers (NACTFO)
American Association of Motor Vehicle Administrators (AAMVA)
National League of Cities (NLC)
Federation of Tax Administrators (FTA)
National Association of State Treasurers (NAST)

before the

Subcommittee on Consumer Credit and Insurance
U.S. House of Representatives
Committee on Banking, Finance and Urban Affairs

February 10, 1994

Statement of Jeffrey L. Esser
Executive Director
Government Finance Officers Association
before the
House Subcommittee on Consumer Credit and Insurance

February 10, 1994

Good morning, Mr. Chairman and members of the Subcommittee. My name is Jeffrey L. Esser. I am Executive Director of the Government Finance Officers Association, headquartered in Chicago, Illinois, and I am here today on behalf of GFOA and seven other state and local government organizations in support of H.R. 2175, the Credit Card Reform Act. These organizations represent public finance and other public officials, both elected and appointed, from all 50 states and the District of Columbia and their agencies, and local governments including counties, cities, towns and special districts.

Mr. Chairman, state and local governments are continually looking for ways to improve service to their citizens and to address their concerns. Many of our citizens have requested that their jurisdictions allow more convenient, quick and flexible methods of payment for governmental charges that enable them to avoid late payment fees and stretch their payments out over time. At the same time, state and local governments are also attempting to minimize the costs of collecting and processing payments from their citizens and to expedite deposit of these payments into their accounts. As a result, governments across the nation are offering the option of payment by credit card. The most frequent uses are for fines, motor vehicle registration and licensing, recreation services, parking fees and tax payments. The *New York Times* has estimated that

approximately $300 billion is paid annually to governments for fines and fees, a potentially enormous market for the credit card companies.

Despite this growing interest in payment by credit card and the technology that makes it possible, the two largest credit card companies prohibit governments and businesses from passing on discount fees and surcharges imposed by the card companies to those consumers who elect to pay by credit card. With fees ranging from 1.5 to 3 percent, state and local governments find it difficult to absorb the added expense involved. Because governments, unlike businesses, are restricted by statute from adjusting charges to their citizens to cover the high credit card surcharges and fees, all taxpayers, even those who do not use this payment option, must be assessed higher taxes to cover these costs. As a matter of public policy and consumer protection, state and local governments believe it is unfair to force all taxpayers to bear the costs of a service utilized by only a portion of the population. Despite the assertion of VISA and MasterCard that their policy is designed to protect consumers, we maintain that this policy is instead clearly anti-consumer and anti-taxpayer. The state and local governments represented here today supporting H.R. 2175 occupy the true pro-consumer position. Passage of this bill would allow us to provide various payment options, with full disclosure regarding any additional fees, for all taxpayers, but without requiring those who do not use credit cards to pay for them.

Mr. Chairman, VISA and MasterCard and their allies have advanced a number of arguments in opposition to allowing state and local governments to pass on these fees. While these are dealt with in detail in our written testimony, I would point out that these

arguments fail to recognize the essential differences between the private and public sectors. Because of the nature of governmental payments, the ability to pay by credit card does not increase demand for services, cannot add to a government's profit margin, cannot increase discretionary spending, and does not lead to early payment. Our citizens are required by law to be notified of any increases in governmental charges and have no difficulty understanding that they may incur additional charges if they choose the credit card payment option. We admit, however, that we are mystified by the exceptions to their own policy permitted by the credit card companies as well as the inconsistent enforcement of this policy, and wonder what criteria the card companies use to distinguish transactions in gambling casinos and truckstops from governmental payments.

Our written testimony also cites several examples of jurisdictions facing a dilemma with regard to credit card acceptance. Lexington, Massachusetts, had an established credit card program in which it accepted payments for recreation fees, real estate and personal property taxes, excise taxes and utility payments. Since the town was notified that it could not pass on credit card surcharges, it now accepts credit cards for recreation fees only. Lexington was simply unable to afford the costs.

The Government Finance Officers Association has been in contact with both VISA and MasterCard in an attempt to reach a mutually acceptable compromise on this issue. Despite indicating a willingness to work with the state and local government community, we have seen no serious intent to modify their prohibitions, and we have our doubts that consumer interests will be safeguarded in a market dominated by only a few firms. We have been gratified by the actions taken by Discover Card in allowing their usage fees to

be passed on, and they have already entered into agreements with many jurisdictions.

In conclusion, Mr. Chairman, we urge the subcommittee to approve H.R. 2175. In an era where governments at all levels have recognized the need to serve our citizens more efficiently and with less expense, the state and local government groups represented here urge this subcommittee to allow us to carry out our responsibilities to our citizens and taxpayers in a fair and equitable manner.

We appreciate the opportunity to testify here today and look forward to working with the subcommittee on this important issue.

INTRODUCTION

My name is Jeffrey L. Esser. I am the Executive Director of the Government Finance Officers Association (GFOA). I am here today on behalf of GFOA and seven other state and local government organizations in support of H.R. 2175, the Credit Card Reform Act, a bill introduced by Representative Jim Moran (D-VA) that would prohibit credit card issuers from limiting the ability of governmental agencies to pass on fees to those who use their credit cards for payments to governments. These organizations represent public finance officials, treasury managers and other public officials, both elected and appointed, from all 50 states and the District of Columbia and their agencies, and local governments including counties, cities, towns and special districts.

CREDIT CARD USAGE

State and local governments are continually looking for ways to improve service to our citizens and to address their concerns. Many of our citizens have requested that their jurisdictions allow more convenient, quick and flexible methods of payment for governmental charges that enable them to avoid late payment fees and stretch their payments out as a means of managing their own cash and expenditures. In addition, state and local governments have also undertaken efforts to minimize the costs of collecting and processing payments from citizens and expedite deposit of these payments into their accounts. As a result, governments across the nation are offering the option of payment by credit card.

In a 1991 survey conducted by the District of Columbia Treasurer's Office, 45 state and local governments and 23 federal government agencies were surveyed. This survey found that 65 percent of these government entities accepted credit cards. More recently, many states, including New York, North Carolina and Connecticut have passed legislation authorizing the acceptance of credit cards for certain government payments. The most frequent uses are for fines, motor vehicle registration and licensing, recreation services, and parking fees. Some jurisdictions also accept cards for tax payments. The New York Times (March 7, 1993) has estimated that approximately $300 billion is paid annually in fine and fees to governments. Surely this represents an enormous potential market for the credit card companies, as all local governments collect taxes, fines and fees.

And, on the federal level, in his Report of the National Performance Review, issued last year, Vice President Al Gore recommends that the Internal Revenue Service develop a system that lets people pay federal taxes by credit card in order to increase customer convenience. H.R. 13, introduced in 1993, includes a provision authorizing payment of federal income taxes by credit card.

Mr. Chairman, despite this growing interest in the credit card method of payment and the expanding technology that makes it possible, the two largest credit card

companies, as a matter of policy, prohibit both governments and businesses from passing on discount fees or surcharges to those consumers who elect to pay by credit card. Compounding this problem, state and local governments that wish to implement this option find it difficult to do so because of the added expense involved. Credit card fees can be quite costly, ranging from 1.5 to 3 percent of the value of the transaction, regardless of the amount of the payment. In other words, a $20 payment of a fee and a $2,000 tax payment will incur surcharges at the same rate, despite the fact that their processing fees are the same.

State and local governments, unlike businesses, collect taxes, fines, forfeitures and other assessments. In most cases, unlike businesses, state and local governments cannot adjust their pricing to cover the costs of collection. Many governments are prohibited by law from deducting such fees from the amount of taxes legally owed to them. Some governments are unable to absorb these usage fees, particularly smaller governments that have less leverage than large volume users in negotiating favorable arrangements with their financial institutions. And, as a matter of public policy and consumer protection, state and local governments believe it is unfair to force all taxpayers to bear the costs of a service utilized by only a portion of the population.

Mr. Chairman, despite the assertion of VISA and MasterCard that the primary purpose of their policy is the protection of the consumer, we maintain that this policy is instead anti-taxpayer and anti-consumer. The state and local governments represented here today, which have passed resolutions supporting H.R. 2175, occupy the true pro-consumer position. Passage of this bill would allow us to provide various payment options, with full disclosure regarding any additional fees, for all taxpayers, but without requiring those who do not use credit cards to pay for them.

ARGUMENTS AGAINST LIFTING THE SURCHARGE PROHIBITION

Several major arguments have been advanced by the credit card companies and those groups claiming to represent consumers on this issue in opposition to allowing state and local governments to pass on these fees. We would like to address these arguments.

We point out initially, however, that all of these assertions ignore the basic difference between the private and public sectors, including the very natures of the types of "purchases" and the methods by which payment decisions are made in each sector.

- First, these groups claim that credit card processing fees are simply another cost of doing business, just as acceptance of cash and checks are, and should therefore be absorbed by the government. Contrary to the claims of opponents of this legislation, the charges associated with cash and check payments are minimal when compared with the surcharges imposed by the credit card companies. As another witness at this hearing

will testify, the costs of credit cards to a government run considerably higher than those associated with the processing, handling, and collection costs of cash and checks. If the cost of acceptance of credit cards were as low as those for cash and checks, governments would be able to absorb those costs easily.

- A second corollary argument states that the costs of credit cards to a government are offset by the savings associated with improved collections and reduced staff time spent processing transactions and following up on bad checks. While it is true that the processing of credit card payments is more timely and efficient than that of other types of payments, estimates of the cost savings to governments resulting from the use of credit cards indicate that the savings are insufficient to offset the average surcharge. However, even if there were any basis for this argument, we believe that a state or local government that is able to effect any cost savings on behalf of its taxpayers should pass those savings on to those taxpayers and not simply transfer them to a credit card company.

- Third, these groups argue that acceptance of credit card payments for services increase demand, thereby generating additional revenue that will both offset usage fees and add to a jurisdiction's coffers, and that credit cards encourage early and prompt payment. Unlike retailers, however, governments have no profit motive in the collection of taxes and fees; nor is there a discretionary spending factor involved in payments to governments. In addition, there is no evidence that those citizens utilizing the credit card payment option pay any earlier than those choosing any other method of payment. In fact, because of the ease and speed of payment associated with credit cards, most jurisdictions find that payments are made at or near their due dates.

- Fourth, it is claimed that taxpayers are confused when they encounter a surcharge imposed by a government. Unlike businesses, many jurisdictions are required by statute to hold public hearings whenever fees are to be increased, providing an opportunity for public notice and comment. Even without this process, however, public officials apparently have more faith in our citizens than the credit card companies have. We believe that our citizens are smart enough to understand that, given proper notification, if they choose the credit card payment option, a surcharge will be added. In fact, we have found that citizens do not object to paying the fee to enjoy the convenience credit card payments offer. Because there is no opportunity to comparison shop with regard to governmental payments, and no reliance on advertisements or marketing gimmicks, these elements do not enter into the decision to use credit cards for governmental payments.

- Finally, state and local governments admit they are mystified by what the credit card companies *do* allow -- that is, the permission that has been granted by at least one credit card company to gambling casinos and truck stops to pass on surcharges incurred by their credit card customers, while governments are prohibited from doing so. What is the criteria used, Mr. Chairman, to distinguish these transactions from ours? Why

are the providers of these "services" able to pass on surcharges or fees but not the providers of mandatory government services?

Mr. Chairman, there are examples from many jurisdictions illustrating the dilemma of state and local governments. In your own state of Massachusetts, the state has encouraged motor vehicle administrators to implement the use of credit cards, but the experience of Lexington, Massachusetts, is telling. Lexington had an extensive credit card program established in which it accepted credit cards for the payment of recreation fees, real estate taxes, personal property taxes, excise taxes, and water and sewer payments when it was informed by VISA and MasterCard of their prohibition. As a result, Lexington now permits use of credit cards for recreation fees only because it is simply unable to absorb these costs. Many other Massachusetts jurisdictions are also eager to use credit cards, but are unable to do so because of the fee obstacle.

Groton, Connecticut, began accepting credit card payments for tax bills in 1991. The town was charged 1.8 percent on the total dollar amount of tax payments. During 1992, Groton taxpayers charged over $600,000 to either VISA or MasterCard for those payments, and Groton paid more than $10,000 in processing fees. This amount was expected to be even greater in 1993. However, Groton was notified by both credit card companies that, despite a 1993 law passed by the State of Connecticut permitting municipalities to pass on fees charged in connection with credit card use, such charges to the card users would not be permitted. Groton Finance Director Sal Pandolfo stated that the only other way in which the town could recoup these costs was through higher taxes, and that Groton officials believed it was unfair for those who do not charge their taxes to have to pay for those who do. For a town like Groton, with an annual budget of $70 million, a charge of over $10,000 to pay for credit card processing fees is difficult to justify.

The Groton Town Council subsequently directed officials to stop accepting tax payments made by those using credit cards that restrict the passing on of fees for governments. Groton now accepts only Discover Card, which does allow the fee to be assessed to the card user.

The passage of H.R. 2175 will recognize the difference between business and government and allow state and local governments like Lexington and Groton to better serve their citizens by providing payment options to all and by assessing only those who use the credit card option an additional fee.

STATE AND LOCAL GOVERNMENT RESPONSES

Because of the lack of a fair policy and inconsistent enforcement of the policy that exists, state and local governments have responded to these prohibitions on collecting surcharges in a variety of ways.

- Some governments, including the federal government, maintain compensating balances with financial institutions processing the transactions to pay for the "hidden costs" of accepting credit card payments.

  In those cases where compensating balances are used to cover the cost of surcharges, it may appear as if a government is only using funds that would otherwise sit idle in its bank accounts and that no real costs are incurred. In fact, these are still public funds that are paid, whether they come out of appropriated monies or a jurisdiction's credit line. We believe that taxpayers would disapprove of the use of credit cards if they realized the true cost of credit card surcharges paid in this manner.

- Other jurisdictions, such as the Wisconsin Department of Motor Vehicles, use outside vendors to process credit card transactions, and the credit card companies have generally not opposed passing on the fees is these cases. A few governments have been given permission by the credit card companies to pass on special handling fees for so-called "value added" services, such as pay-by-phone options.

  Both situations represent responses to attempts by the credit card companies to portray the additional charges as being imposed by the government and not by the credit card company. Where third-party vendors are used as processing agents, a government pays not only the cost of the surcharge, but a fee to the vendor as well. Thus, the credit card user is charged even more than the initial cost of the surcharge and the government ends up paying an additional cost to outside processors, all in order to convince a credit card company that the surcharge in not being passed on in contravention of its policy.

- Some governments, with the understanding that they are permitted to do so, continue to pass on surcharges until the credit card operators direct financial institutions that are doing business with state and local governments to discontinue this arrangement. Typically, banks sign agreements with these jurisdictions that cover the types of services that will be provided and the related service charges. It is the financial institutions that receive particular pressure from the credit card companies to cease doing credit card business with any governmental entity that passes on surcharges or fees.

VOLUNTARY AGREEMENTS

The Government Finance Officers Association has been in contact with both VISA and MasterCard during the past year in order to attempt to reach a mutually acceptable compromise on this issue. The credit card companies, in fact, have several times indicated a willingness to work with us and we remain receptive to their views. However,

we have seen no movement to date despite our encouragement that they voluntarily modify their prohibitions on state and local government collection of usage fees, and we have our doubts that consumer interests will be safeguarded in a market where a few firms dominate. We have been gratified by the response of Discover Card in allowing their usage fees to be passed on to the cardholder. Many state and local jurisdictions have already reached agreements with Discover Card and are already utilizing this credit card.

CONCLUSION

In conclusion, Mr. Chairman, we urge this subcommittee to approve H.R. 2175 in order to lift the prohibition on state and local governments which prevents us from passing on surcharges and fees to those who use credit cards for governmental payments. While we believe that this method of payment is an important and innovative one that our taxpayers are entitled to have available, we also believe it is unfair to those who do not use this payment option to pay the excessive costs associated with it. It now appears that, despite state and local government efforts to forge a voluntary resolution to this impasse, this legislation represents our best opportunity for a solution.

In an era where government at all levels has recognized the need to serve its citizens more efficiently and with less expense, and where the technology is now available for us to do so, the state and local government groups represented here urge this subcommittee to give us the flexibility to provide these services and to allow us to carry out our responsibilities to our citizens and taxpayers.

We appreciate your interest in this matter, Mr. Chairman. Our organizations will be happy to assist you in any way as you address this issue.

For more information, contact the following:

Betsy Dotson, GFOA	202/429-2750
Stacey Crane, MTA	202/833-1017
Ralph Tabor, NACo and NACTFO	202/393-6226
David H. Hugel, AAMVA	703/522-4200
Frank Shafroth, NLC	202/626-3000
Verenda Smith, FTA	202/624-5890
Milton Wells, NAST	202/624-8595

MTA
US&C
Municipal Treasurers' Association
of the United States and Canada

March 7, 1994

Subcommittee on Consumer Credit and Insurance
Room 604, O'Neill House Office Building
Washington, DC 20515
ATTN: Jennifer Butera

Dear Jennifer:

Per your instruction, I have enclosed a resolution on governmental agencies assessing usage fees on payments by credit card which was adopted last August by the Municipal Treasurers' Association of the United States and Canada.

The Subcommittee on Consumer Credit and Insurance held a hearing on February 10 on H.R. 2175, and I understand that the hearing record has been kept open for four weeks. I would appreciate the enclosed resolution be placed in that record.

If you have any questions, please do not hesitate to contact me at (202) 833-1017.

Thank you for your assistance.

Sincerely,

Deborah Reuter

Deborah Reuter
Staff Associate

MTA
US&C
Municipal Treasurers' Association
of the United States and Canada

RESOLUTION ON GOVERNMENTAL AGENCIES ASSESSING USAGE FEES ON PAYMENTS BY CREDIT CARD

WHEREAS, the use of credit cards provides the public with a convenient alternative to pay for state and local government taxes, fees, fines and other charges, and;

WHEREAS, payment by credit card is extremely beneficial to state and local governments as it results in low cost processing, an acceleration of collections, a reduction in delinquent accounts, and a decrease in bad checks, and;

WHEREAS, governmental agencies are forced to pass on the fee for using a credit card to the user since, unlike business merchants, they collect taxes, fines, forfeitures and other involuntary assessments and are unable to adjust their "pricing" to cover the costs of such collections, and;

WHEREAS, state and local governments are required to collect 100 percent of the tax, fee or fine assessed and thus are unable to deduct such usage fees from the amount owed, and;

WHEREAS, governmental entities should not be required to absorb credit card usage fees as it would result in all taxpayers bearing the cost for those who opt to pay by credit card, and;

THEREFORE, BE IT RESOLVED that credit card issuers should not prohibit or otherwise limit state and local governments from assessing and collecting a fee from those who pay by credit card, and;

BE IT FURTHER RESOLVED that the Municipal Treasurers' Association supports legislation that would forbid credit card vendors from limiting the ability of governmental agencies to charge fees for honoring credit cards.

By the President of MTA US&C

Tony Davenport

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